Supreme Court, U.S.
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No. 86-751

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

JOINT APPENDIX

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PETITION FOR WRIT OF CERTIORARI FILED NOVEMBER 7, 1986
WRIT OF CERTIORARI GRANTED MARCH 23, 1987

TABLE OF CONTENTS

	Page
Chronological List of Relevant Docket Entries	1
Stipulation of Facts/Documents, filed June 6, 1983	2
Opinion of the United States Tax Court, filed October 29, 1984	Pet. App. B-1*
Decision of the United States Tax Court, entered March 5, 1985	21
Opinion of the United States Court of Appeals for the Eighth Circuit, including Dissenting Opinion, filed September 9, 1986	Pet. App. A-1*
Judgment of the United States Court of Appeals for the Eighth Circuit, entered September 9, 1986	23
Order of the Supreme Court of the United States allowing Certiorari, filed March 23, 1987	24

* The opinions of the United States Tax Court and the United States Court of Appeals for the Eighth Circuit appear in the Appendix to the Petition for Writ of Certiorari at B-1 and A-1, respectively.

CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

October 9, 1980 — Petitioner Arkansas Best Corporation and Subsidiaries files original petition in the United States Tax Court.

December 5, 1981 — Respondent Commissioner of Internal Revenue files original answer.

June 6, 1983 — Bench trial commences.

October 29, 1984 — Memorandum findings of fact and opinion issued by Judge Nims of the United States Tax Court.

March 5, 1985 — Decision entered by Judge Nims of the United States Tax Court.

May 31, 1985 — Respondent files notice of appeal to the United States Court of Appeals for the Eighth Circuit.

June 27, 1985 — Petitioner files notice of appeal to the United States Court of Appeals for the Eighth Circuit.

February 13, 1986 — Oral argument heard by the United States Court of Appeals for the Eighth Circuit.

September 9, 1986 — Opinion issued by the United States Court of Appeals for the Eighth Circuit.

September 25, 1986 — Petitioner files motion to stay issuance of mandate.

October 8, 1986 — Order to stay issuance of mandate pending certiorari proceedings issued by the United States Court of Appeals for the Eighth Circuit.

November 7, 1986 — Petitioner files petition for writ of certiorari in the United States Supreme Court.

February 19, 1987 — Respondent files brief on petition for writ of certiorari.

March 23, 1987 — Petition for writ of certiorari granted by the United States Supreme Court.

UNITED STATES TAX COURT

ARKANSAS BEST CORPORATION AND SUBSIDIARIES, *Petitioner,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Docket No. 18954-80

STIPULATION OF FACTS/DOCUMENTS

The parties in the above-entitled action, by and through their attorneys of record, stipulate and agree that the following facts are true and correct and may be offered into evidence in the trial of this case, subject to the right of the parties to introduce other and further evidence not inconsistent with this stipulation. The parties further stipulate that the Exhibits attached hereto and described hereafter meet all requirements of authentication, identification and admissibility within the meaning and scope of the Federal Rules of Evidence. No stipulation as to relevance or materiality of any of the subsequent paragraphs is to be inferred by the parties' agreements as to authenticity.

1. Arkansas Best Corporation ("ABC") is a Delaware corporation with principal offices at 1000 S. 21st Street, Fort Smith, Arkansas 72901. ABC is a publicly-held corporation. During the period from 1968 to 1975, ABC owned 50% or more of the stock in the following businesses:

(a) Arkansas Best Freight System, Inc., now ABF Freight System, Inc., a company engaged in interstate trucking;

(b) Riverside Furniture Corporation, a company engaged in furniture manufacturing, distribution and sales;

(c) Data-Tronics Corp., a company engaged in data processing services;

(d) Arkansas Bandag Corporation, now ABC Treadco, Inc., a company engaged in new tire sales and retreading; and

(e) National Bank of Commerce, Dallas, Texas ("NBC"), engaged in banking.

2. Petitioner timely filed consolidated income tax returns with the Internal Revenue Service in Austin, Texas for each of the calendar years in issue (1969 through 1976). Copies of the tax returns for the taxable years 1969 through 1976 are attached hereto as Exhibits 1-A, 2-B, 3-C, 4-D, 5-E, 6-F, 7-G and 8-H, respectively.

3. Attached hereto as Exhibit 9-I is a copy of the Statutory Notice of Deficiency ("S/N") dated July 10, 1980, which was timely mailed to petitioner.

4. All issues set forth in the S/N except the following have been settled:

(a) The $9,995,688 claimed ordinary loss disallowed by the Commissioner, which ABC had claimed in connection with the June 30, 1975, sale to F. E. Anderson, et al., of 661,000 shares of the common stock of NBC, which the Commissioner treated as a capital loss. (S/N adjustment (f), p. 9, Schedule 1-A. and Schedule 1-B, item (f), p. 11).

(b) The $4,353,676 ordinary loss claimed by ABC in connection with its April 2, 1976 sale to Coke L. Gage of a $6,006,176 note of F. E. Anderson, et al., received as a portion of the total consideration for the 661,000 shares of NBC common stock referred to in paragraph 5(a) above.

(S/N adjustment (i), p. 7, and Schedule 1-C, item (i), p. 8). In addition, Petitioner incurred legal expenses of $5,050 and a commission expense of $33,050, for a total claimed ordinary loss of $4,391,776.

5. In addition to the issues set forth in paragraph 5 above, petitioner asserts that it is entitled to an unclaimed ordinary loss not claimed on its tax return for the year 1976, in the amount of $493,982.00. Said loss occurred in connection with a sale by ABC of 15,000 shares of NBC's common stock to William R. Riley. (See Petition paragraph 4(c) and 5(a)(xv) and (a)(xvi)). The Respondent contends that the loss is a capital loss.

6. The parties not only disagree as to the character of the losses set forth in paragraphs 4(a) and 5, but also as to the amounts of such losses, as set forth in paragraphs 7 and 8 below:

7. Petitioner's basis for the 661,000 shares of NBC stock sold in June, 1975 is $16,062,286 if petitioner is entitled to include in its basis the pro rata portion of the 150,000 shares of $10.00 par preferred stock transferred to Young, Inc. and petitioner's basis is $14,966,299 if petitioner is not entitled to include the preferred stock in its basis.

8. Petitioner's basis for the 15,000 shares of NBC stock sold to William R. Riley in 1976 is $526,982 if petitioner is entitled to include in its basis the pro rata portion of the 150,000 shares of $10.00 par preferred stock transferred to Young, Inc. and petitioner's basis is $419,333 if petitioner is not entitled to include the preferred stock in its basis. Petitioner incurred sales expenses of $660 and legal expenses of $2,525 in connection with this sale.

9. From the date of ABC's incorporation in 1966 until the date of his death, in August 1973, Robert A. Young, Jr.

(hereinafter "Mr. Young") served as the Chairman of the Board of ABC. In March of 1967 Mr. Young acquired (i) 190,000 shares of common stock of NBC, and (ii) a promissory note from Mr. J. G. Lawrence in the principal amount of $468,869.22 plus accrued interest of $31,122.31 secured by 11,916 shares of NBC common stock, from Mr. Troy Post in a private sale in which neither NBC nor Mr. Post requested an investment letter from Mr. Young. Mr. Young paid Mr. Post $5,933,991.53 in total consideration, including a cash payment of $933,991.53 and a note for $5,000,000. A copy of the agreement of sale between Messrs. Young and Post, together with copies of related exhibits and correspondence, are attached as Exhibits 10 through 15. Mr. Young obtained the cash necessary for the purchase through a $950,000 loan from the First National City Bank, New York, New York. Subsequently, Mr. Lawrence sold the NBC common stock securing the $468,869 note and used the proceeds of those sales together with other funds, to satisfy his indebtedness to Mr. Young. Mr. Young, in turn, used the proceeds to reduce the principal amount of his indebtedness to Mr. Post. By August 23, 1967, the principal of the $5,000,000 note due Mr. Post had been reduced to $4,496,955.

10. In December 1967 Mr. Young obtained an option to acquire 24,534 shares of 6% Convertible Preferred Stock of NBC from Messrs. Michaux Nash, Sr., and Michaux Nash, Jr., in consideration of Mr. Young's guarantee of debts totalling $1,145,700 then secured by that stock. A copy of the letter agreement establishing this option is attached as Exhibit 16. These shares were convertible into an equal number of shares of the common stock of NBC, and together with the 190,000 shares earlier acquired from Mr. Post, gave Mr. Young common stock, or the right to acquire common stock, totaling 51¾% of the outstanding voting stock of NBC at December 31, 1967.

11. In March 1968 Mr. Young acquired 19,013 shares of NBC common stock from NBC in a preemptive rights offering for $351,741.

12. In April 1968 Mr. Young acquired $742,600 principal amount of 5.5% Capital Convertible Debentures of NBC at par from NBC. These capital convertible debentures were convertible into 29,704 shares of NBC common stock.

13. Both the 19,013 shares of NBC common stock acquired in March 1968 and the $742,600 principal amount of 5.5% capital convertible debentures of NBC acquired in April 1968 were acquired for cash. Funds for these acquisitions were borrowed from First National Bank of Fort Worth.

14. On June 6, 1968, Mr. Young transferred all his stock and security interests in NBC to Young, Inc., in exchange for 500,000 shares of the common stock of Young, Inc., plus Young, Inc.'s agreement to assume all indebtedness incurred by Mr. Young in connection with his acquisition of the aforesaid stock and security interests. Attached as Exhibit 17 is a copy of the Agreement for Exchange of Stock between Mr. Young and Young, Inc., dated June 6, 1968.

15. Young, Inc., was a personal holding company as that term is defined under the Internal Revenue Code. Young, Inc., organized under the laws of the State of Arkansas, was incorporated on May 20, 1968. A copy of Young, Inc.'s articles of incorporation is attached as Exhibit 18. From the date of its incorporation until its dissolution on November 2, 1973, all of the stock of Young, Inc. was owned by Mr. Young or by his estate. Young, Inc. was formed to serve the general business

and charitable purposes of Mr. Young. On June 28, 1968, assets of Young, Inc., consisted of the following:

Assets	Book Value
Cash	$ 1,000.00
Capital Convertible Debentures of NBC	742,600.00
Contract to purchase 24,534 shares of convertible preferred stock of NBC	1,145,700.00
209,013 shares of common stock of NBC	5,798,196.00

16. On June 29, 1968, pursuant to an Agreement for Exchange of Stock dated June 14, 1968, and following approval of that Agreement by ABC's Board of Directors and shareholders, Young, Inc. transferred to ABC all of its stock and securities of NBC (including 209,013 shares of common stock, 29,704 units of convertible debentures with a par value of $742,600, which ABC converted into 29,704 shares of common stock immediately upon acquisition, and a contract to purchase 24,534 shares of convertible preferred stock, which ABC exercised and converted to 24,534 shares of common stock prior to December 31, 1968) and received 150,000 shares of Series "C" Convertible Preferred Stock of ABC, together with ABC's assumption of Young, Inc.'s outstanding obligations aggregating $7,686,995 ($4,496,955 then owed to Troy Post under the $5,000,000 note referred to in paragraph 6 above; $950,000 owed to the First National City Bank, New York, New York, incurred in connection with Mr. Young's acquisition of Mr. Post's stock; $1,094,340 owed to First National Bank, Fort Worth, Texas, first incurred by Mr. Young to acquire the $742,600 in capital convertible debentures and the 19,013 shares of NBC common stock referred to in paragraphs 11 and 12 above; and $1,145,700 in the form of a guarantee for debt owed to First National Bank, Dallas, Texas, first incurred by

Mr. Young in connection with the option to acquire 24,534 shares of NBC stock obtained in December, 1967). A copy of the June 14, 1968 Agreement for Exchange of Stock, with appendices, between Young, Inc. and ABC is attached as Exhibit 19. Attached are copies of the following minutes and transcripts of meetings approving the sale: Minutes of June 14, 1968, meeting of ABC's executive committee (Exhibit 20); Minutes of June 28, 1968, meeting of ABC's board of directors (Exhibit 21); Minutes of the June 29, 1968, special meeting of ABC's shareholders (Exhibit 22); Transcript of the June 28, 1968, meeting of ABC's board of directors (Exhibit 23); and Transcript of June 29, 1968, special meeting of ABC's shareholders (Exhibit 24). Attached as Exhibit 25 is a copy of the proxy statement issued to ABC's shareholders in connection with the June 29, 1968, special meeting of shareholders. Later in 1968, ABC exercised its option to acquire the 24,534 shares of 6% Convertible Preferred Stock of NBC described above, paying Messrs. Nash, Sr. and Nash, Jr. $1,145,700 for such stock, and exercised its conversion rights. In addition, ABC also acquired the following shares of NBC stock in 1968:

Months	Number of Shares	Cost
February	2,071	$55,173
April	207	3,830
June	1,085	27,125

As a result of these transactions, ABC acquired 266,614 shares of NBC common stock, which constituted 64.97 percent of the outstanding common stock of NBC at December 31, 1968.

17. Young, Inc. gave ABC an investment letter with respect to the ABC stock it received under the June 14, 1968, agreement for exchange of stock. A copy of that letter appears as

Exhibit 26. ABC did not give Young, Inc. an investment letter in connection with the transaction.

18. On March 18, 1969, ABC's stock was listed on the American Stock Exchange. Previously, its stock has been traded in the over-the-counter market. On December 20, 1972, ABC stock was listed on the New York Stock Exchange.

19. ABC obtained opinions concerning the value of NBC's common stock from the investment banking firms of Brown, Allen & Co., Almon & Co. and Ling & Co., Inc., prior to its June 29, 1968 acquisition of the assets of Young, Inc. Copies of those opinions are attached as Exhibits 27, 28 and 29. ABC also obtained an opinion from Ling & Co., Inc. concerning the value of the 150,000 shares of preferred stock. A copy of that opinion is attached hereto as Exhibit P(F).

20. During the years 1969 through 1974, the Comptroller made a series of determinations that NBC's capital was inadequate. Following negotiations involving the Comptroller and the Board of Directors of NBC, ABC exercised its preemptive rights in a series of stock offerings designed to increase NBC's capital ("capital calls"). The concerns of the bank examiners were expressed orally and in writing. A letter to NBC from Billy C. Wood, Deputy Regional Administrator of National Banks, dated December 29, 1970, indicated that NBC's capital structure was inadequate. A copy of that letter is attached as Exhibit 30.

21. During 1969, ABC participated in two NBC capital calls made to address the concerns of federal bank regulators that NBC was not adequately capitalized. In those calls, ABC acquired an additional 142,670 shares of NBC common stock at an aggregate cost of $3,639,266. In the first call, ABC acquired 70,154 shares at an aggregate cost of $1,753,850 ($25 per share). In the second call, ABC acquired 72,516 shares at an aggregate cost of $1,885,416 ($26 per share). In addition, ABC

also acquired 24,188 shares of NBC stock for aggregate consideration of $723,928. At December 31, 1969, ABC owned 433,472 shares of NBC's common stock, constituting 60.43 percent of NBC's common stock outstanding on that date.

22. During 1970, ABC made no additional acquisitions of NBC stock. ABC owned 433,472 shares of NBC's common stock at December 31, 1970.

23. On December 31, 1970, Congress enacted the 1970 Amendments to the Bank Holding Company Act. Under the Amendments to the Act and regulations promulgated thereunder (specifically 12 C.F.R. #225.2 (1981)), ABC was deemed to be "in control" of NBC for purposes of the Bank Holding Company Act, and therefore to be a "bank holding company" as defined in 12 U.S.C.A. #1841(a)(1) (1980).

24. Pursuant to the provisions of the Bank Holding Company Act, as amended in 1970, on or about July 30, 1971, ABC filed "an irrevocable declaration" with The Federal Reserve Bank of Dallas, to cease to be a bank holding company by divesting itself of control of the National Bank of Commerce, Dallas, Texas, not later than January 1, 1981. A copy of the declaration and the resolution by the Board of Directors of ABC are attached as Exhibit 31.

25. After filing its "irrevocable declaration" of intent to divest itself of its controlling interest in NBC, ABC through its subsidiaries acquired interests in the following businesses:

(a) Interstate Trucking

(1) Youngblood Truck Lines, Inc. (1971)

(2) Nicklaus Transfer & Storage Co. (1974)

(4) Navajo Freight Lines, Inc. (1978)

(5) Western Gillette (1979)

(6) East Texas Motor Freight (1982)

(b) Furniture

(1) Coffey Furniture Industries, Inc. (1973)

(c) Data Services

(1) Norvel Systems, Inc. (1972)

(d) Tire Retreading

(1) Southwest Bandag, Inc. (1977)

(2) Uniroyal of Dania, Florida (1980)

26. During 1971, ABC obtained 43,347 shares of NBC common stock when NBC declared a stock dividend, increasing the aggregate number of shares of NBC's common stock held by ABC to 476,819 at December 31, 1971.

27. During 1972, ABC obtained 19,072 shares of NBC common stock when NBC declared a stock dividend, and acquired 95,363 shares of NBC common stock in a capital call for aggregate consideration of $2,407,915 ($25.25 per share). This capital call was made to address the concerns of federal bank regulators that NBC was inadequately capitalized. On November 11, 1972, ABC acquired 6,165 shares of NBC stock from John Grey, for $616,500. At December 31, 1972, ABC held 597,419 shares of the outstanding common stock of NBC, 60.18 percent of the stock outstanding on that date.

28. During 1973:

(a) ABC obtained 23,902 shares of NBC common stock when NBC declared a stock dividend; acquired 103,887 shares of the common stock of NBC in a capital call in October, 1973 for aggregate consideration of $2,077,740 ($20 per share); acquired 135 shares of NBC common stock from John Grey for $13,500 and acquired $3,116,610 of NBC's 8% Capital Convertible Debentures in a capital call. At issuance,

the debentures were convertible into NBC common stock at $30 per share. No debentures had been converted by December 31, 1973, at which date ABC owned 700,343 shares of the common stock of NBC (see paragraph 28(b), below, with respect to sale by ABC of 25,000 shares), 59.95 percent of the NBC common stock then outstanding;

(b) ABC sold 25,000 shares of the NBC stock ABC had acquired in the October, 1973 capital call to John W. Hazard for $493,750 ($19.75 per share). The difference between the price of the stock to ABC and the price to Mr. Hazard reflected a $0.25 cash dividend per share paid ABC before the stock was sold to Mr. Hazard.

(c) NBC recognized loan losses of $12,778,821 (net of recoveries) and increased its loan reserves $572,912 from $982,072 to $1,554,984. NBC had a net loss for the year of $10,201,381. Attached hereto as Exhibit 58 is a copy of the 1973 NBC Annual Report.

29. During 1974:

(a) NBC reduced from $30 to $25 per share the conversion price of its capital convertible debentures and ABC converted its $3,116,610 in debentures to 124,664 shares of NBC's common stock; ABC acquired 2,402 shares of NBC common stock for $61,946 from Universal Insurance Company, a corporation subsequently acquired by ABC as a consolidated subsidiary; and ABC reacquired from John W. Hazard the 25,000 shares sold to Mr. Hazard in 1973 for $493,750 (the cost of the shares to Mr. Hazard). At December 31, 1974, ABC owned 852,409 shares of the common stock of NBC, representing 65.77 percent of NBC's then outstanding common stock.

(b) NBC experienced loan losses of $2,621,628 (net of recoveries) and increased its loan loss reserve $2,195,016

from $1,554,984 to $3,750,000 (excluding an additional $1,800,000 received from ABC in February, 1975 as consideration for $5,000,000 in previously charged-off notes). NBC had a net loss for the year of $4,627,012.

(c) Attached hereto as Exhibit 59 is the 1974 NBC Annual Report.

30. During 1975:

(a) NBC sold ABC $5,000,000 in previously charged-off loans in February, 1975 for $1,800,000 on terms that assured that NBC would realize the benefit of any recovery in excess of ABC's cost and expenses. The amount received by NBC was added to its loss reserve.

(b) On June 30, 1975, ABC sold 661,000 shares of NBC common stock to a group of 63 Texas investors. In exchange for this stock, which constituted 51 percent of the then outstanding stock of NBC, ABC received (i) $1,059,914 in cash, and (ii) a note ("Note") face amount $6,006,176, secured by the 661,000 shares of stock. The parties have agreed that the fair market value of the Note on June 30, 1975 was $4,878,088. Attached are copies of the following documents with respect to this sale: Definitive Stock Purchase Agreement and Grant of Security Interest (Exhibit 32); Note (Exhibit 33); Pledge and Security Agreement (Exhibit 34); Voting Trust (Exhibit 35); and list of investors (Exhibit 36). The net asset value per share of NBC as reflected in NBC's June 30, 1975 statement of condition, attached hereto as Exhibit 60, was $10.69 per share.

(c) The net asset value per share of NBC as reflected in NBC's December 31, 1975 statement of condition, attached hereto as Exhibit 61, was $2.30 per share.

31. As a result of the loans classified as uncollectible or doubtful during the examination conducted in July and August

of 1975 the Comptroller required NBC to increase its capital by a minimum of $8,000,000. Attached are copies of: a letter dated December 4, 1975, from ABC to Edward C. Nash, Jr., Fred T. Brooks and H. D. Stanley, Trustees for the investors (Exhibit 37); Mr. Nash's December 5, 1975 telegram (Exhibit 38); a telegram dated December 8, 1975 by ABC to Mr. Nash, et al. (Exhibit 39); a letter dated December 9, 1975, to ABC from Carl E. Oates, counsel for the Trustees representing the investors (Exhibit 40); a telegram dated December 9, 1975 from Carl E. Oates, as counsel for the Trustees, to ABC (Exhibit 62); and ABC's letter dated December 10, 1975, to Carl E. Oates (Exhibit 41).

32. On January 21, 1976, ABC made a book entry writing down the value of the Note by $4,485,876. A copy of the ledger sheets reflecting this entry is attached as Exhibit 63. The charge-off against the value of the Note was also reflected in ABC's 1975 annual report. A copy of ABC's 1975 Annual Report (with references to the charge-off appearing at pages 15, 18 and 19) is attached hereto as Exhibit 64.

33. A claim for a deduction arising from the partial worthlessness of the Note was set forth in ABC's Protest dated June 9, 1978. A copy of that Protest is attached hereto as Exhibit 65.

34. In April, 1976, ABC sold the Note acquired on June 30, 1975, to Mr. Coke L. Gage for $1,652,500. As a condition of this sale, ABC acquired an additional 573,953 shares of NBC's common stock in a capital call for $1,233,999. In connection with the sale of the Note, ABC incurred sales expenses of $33,050 and legal fees of $5,050. The following are copies of the principal documents setting forth the agreement between ABC and Mr. Gage:

(a) Memorandum of Agreement dated February 9, 1976, between ABC and Mr. Gage (Exhibit 42);

(b) Assignment dated April 7, 1976, between ABC and Mr. Gage (Exhibit 43);

(c) Memorandum dated April 8, 1976, from S. Walton Maurras to David Stubblefield (Exhibit 44);

(d) Letter dated April 7, 1976, from James C. Travis of NBC to ABC, Mr. Gage and William R. Riley (Exhibit 45);

(e) Endorsement to the June 30, 1975, note, dated April 7, 1976, from ABC to Mr. Gage (Exhibit 46);

(f) Release executed by Fred T. Brooks and Edward C. Nash, Jr. on April 7, 1976, releasing ABC from obligations set forth in Article VII of the Definitive Stock Purchase Agreement and Grant of Security Interest dated June 30, 1975 (Exhibit 47);

(g) Acknowledgment dated April 7, 1976, from Mr. Gage to ABC notifying ABC of the satisfaction of the conditions set forth in paragraphs 2(a) and (b) of the February 9, 1976, memorandum agreement (Exhibit 48);

(h) Acknowledgement dated April 7, 1976, from Coke L. Gage reflecting receipt of the original executed instrument entitled Voting Trust Agreement (Exhibit 49);

(i) Receipt for stock certificate dated April 7, 1976, executed by Mr. Gage (Exhibit 50);

(j) Release dated April 7, 1976, executed by Edward Nash, Jr. on behalf of NBC releasing ABC from all obligations pursuant to a June 30, 1975, commitment letter from ABC to NBC (relating to subordinated capital debentures, notes and other securities of NBC) (Exhibit 51);

(k) Subscription Agreement dated April 7, 1976, pursuant to which Mr. Gage unconditionally subscribed to

purchase 486,750 shares of the common stock of NBC (Exhibit 52);

(l) Undated Resolution releasing ABC from its commitments concerning subordinated debentures (Exhibit 53);

(m) Letter dated April 1, 1976, from James S. Robertson, Jr., Esq., attorney for Mr. Gage, advising ABC, through its attorney, Thomas Harper, Esq., of the satisfaction of the conditions contained in paragraph 2(b) of the Memorandum of Agreement dated February 9, 1976, (Exhibit 54);

(n) April 21, 1976, proxy statement of ABC (Exhibit 55).

35. Concurrently with the sale to Mr. Gage, ABC granted William R. Riley of Dallas, Texas an option to purchase its remaining 765,362 shares of NBC common stock in annual installments through 1980 at a price of $2.20 per share. William R. Riley or his assignees under an assignment made on August 16, 1978, exercised these option rights as follows:

(a) On December 15, 1976, Mr. Riley acquired 15,000 shares of NBC common stock, so that ABC held 750,362 shares at NBC common stock at December 31, 1976.

(b) On December 25, 1977, Mr. Riley acquired 50,000 shares of the NBC common stock, so that ABC held 700,362 shares of NBC common stock at December 31, 1977.

(c) On December 15, 1978, Mr. Riley or his assignees acquired 215,226 shares of NBC common stock, so that ABC held 485,136 shares of NBC common stock at December 31, 1978.

(d) On June 15, 1979, Mr. Riley or his assignees acquired 215,226 shares of NBC common stock.

(e) On December 15, 1980, Mr. Riley or his assignees acquired 269,910 shares of NBC common stock. Thereafter, ABC owned no shares of NBC common stock, or any other

stock or security interest in NBC. A copy of the Option Agreement is attached as Exhibit 56.

36. ABC received the following dividends and interest payments from NBC with respect to stock and securities owned in NBC:

Year	Dividends	Interest on Debentures	Total
1968	$ 43,292	None	$ 43,292
1969	207,024	None	207,024
1970	325,104	None	325,104
1971	357,614	None	357,614
1972	534,037	None	534,037
1973	635,409	$ 92,806	728,215
1974	None	103,887	103,887
1975	None	None	None
1976	None	None	None
Total	$2,102,480	$196,693	$2,299,173

37. Expressed as a percentage return on capital invested, the dividends and interest paid to ABC with respect to its stock and security interests in NBC were:

Year	Average Capital Account*	Dividends and Interest	Return on Capital
1968	$ 3,886,562	$ 43,292	1.11%
1969	9,954,721	207,024	2.08%
1970	12,136,318	325,104	2.68%
1971	12,136,318	357,614	2.95%
1972	13,648,526	534,037	3.91%
1973	17,517,783	728,215	4.16%
1974	20,152,681	103,887	0.52%
1975	16,897,484	None	0.00%
1976	13,347,939	None	0.00%

* One-half of the sum of the beginning-of-year and end-of-year capital account.

38. ABC experienced the following cash flow with respect to its stock and security interests in NBC:

Year	Dividends and Interest	Principal Capital Infused*	Paid On Initial Acquisition Indebtedness and Interest Paid on All Acquisition Indebtedness	Cumulative Cash Flow Through Year Specified
1968	$ 43,292	$ (86,128)	$(7,042,705)	$ (7,085,541)
1969	207,024	(4,363,194)	(439,262)	(11,680,973)
1970	325,104	-0-	-0-	(11,355,869)
1971	357,614	-0-	(219,841)	(11,218,096)
1972	534,037	(3,024,415)	(142,565)	(13,851,039)
1973	728,215	(1,597,490)	(38,550)	(14,758,864)
1974	103,887	(3,672,296)	(2,935)	(18,330,208)
1975	None	-0-	(37,955)	(18,368,163)
1976	None	(1,233,999)	-0-	(19,602,162)

* Excluding initial acquisition indebtedness.

39. To assist in the sale of its stock in NBC, on or about August 20, 1974, ABC retained the services of Goldman, Sachs & Co. Attached as Exhibit 57 is a copy of a letter from Goldman, Sachs & Co. to Mr. H. L. Hembree dated August 20, 1974.

40. By letter dated April 22, 1981, respondent requested, pursuant to Rule 70(a)(1) of the Tax Court's Rules of Practice and Procedure, that the petitioner respond to certain informal discovery. Attached as Exhibit J is a copy of said letter and attachment (informal discovery requests).

41. On or about August 27, 1981, petitioner's counsel furnished respondent petitioner's responses to respondent's informal discovery. Attached as Exhibit K is the response and attached exhibits.

42. By letter dated October 13, 1981, respondent served formal discovery on petitioner's counsel. Attached as Exhibit L are copies of said letter and attachments.

43. Attached as Exhibit M are petitioner's responses to respondent's formal discovery requests.

44. By letter dated October 28, 1981, respondent served upon petitioner's counsel "Second Interrogatories" and a "Request For Production of Documents". Attached as Exhibit N is a copy of said letter with attachments.

45. On or about January 22, 1982, petitioner's counsel responded to respondent's second formal discovery request. Attached as Exhibit O are copies of petitioner's responses.

46. Respondent requested that petitioner furnish respondent complete copies of all minutes of the meetings of the Board of Directors and Executive Committee of Arkansas Best Corporation at which the National Bank of Commerce was discussed. Attached as Exhibit P are petitioner's counsel's responses to said request.

47. On or about February 15, 1983, petitioner served upon respondent's counsel "Interrogatories". Attached hereto as Exhibit 66 is a copy of respondent's response.

48. The parties have settled the following issues as stated:

ARKANSAS BANDAG CORP.

Item	Statutory Notice	Years	Amount of Adjustment
(a)	Page 21,	1973	$ 6,028
	Schedule 1-B	1974	75,619
		1976	221,281

The Petitioner's tax liability for the years 1973, 1974, 1975 and 1976 will be computed (a) by permitting Petitioner to depreciate truck terminals and tire processing structures to its subsidiary, ABC Treadco, Inc. (formerly Arkansas Bandag Corporation) on which the Commissioner proposed useful lives of twenty-two years or greater over a twenty-two year useful life with no salvage value, and (b) by otherwise computing petitioner's depreciation deductions as proposed by the Commissioner, with the depreciation deductions claimed for those years being reduced $4,492, $49,493, $116,754, and $109,827, respectively.

All adjustments set forth in the statutory notice of deficiency have been conceded by petitioners' counsel to be correct except those set forth in paragraphs 4 and 48 of this Stipulation.

KENNETH W. GIDEON
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(Signed)
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UNITED STATES TAX COURT

ARKANSAS BEST CORPORATION AND SUBSIDIARIES, *Petitioner,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Docket No. 18954-80

DECISION

Pursuant to the opinion of the court filed October 29, 1984, and incorporating herein the facts recited in petitioner's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income taxes and additions to the tax due from the petitioner as follows:

Taxable Year	Deficiencies
1969	$ 20 224.00
1970	20,224.00
1971	50,560.00
1972	2,495,451.00
1973	483,157.00
1974	217,498.00
1975	6,829.00
1976	188,790.00

(Signed)
ARTHUR L. NIMS, III
Judge

Entered: March 5, 1985

• • • •

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the court and the petitioner's computation, and that the court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

(Signed)
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Dated: 2-13-85

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

JUDGMENT

Nos. 85-1702/1818

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,

Appellee, Cross-appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellant/Cross-appellee.

Appeals from the United States Tax Court

These appeals from the United States Tax Court were submitted on the record of the Tax Court, briefs of the parties and were argued by counsel.

After consideration it is ordered and adjudged that the judgment of the Tax Court be affirmed in part and reversed in part consistent with the opinion of this Court.

September 9, 1986

Order entered in
accordance with opinion
(Signed) Robert D. St. Vrain
Clerk, U.S. Court of Appeals,
Eighth Circuit

Supreme Court of the United States

No. 86-751

ARKANSAS BEST CORPORATION,

Petitioner

v.

COMMISSIONER OF THE INTERNAL REVENUE

ORDER ALLOWING CERTIORARI. Filed March 23, 1987.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit is granted.

PETITIONER'S

BRIEF

Supreme Court, U.S.
FILED
MAY 6 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-751

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ of Certiorari to
the United States Court of Appeals
for the Eighth Circuit

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Shall corporate stock, futures contracts, and other securities held for business purposes continue to be treated as non-capital assets, as held by this Court in *Corn Products* and a host of other courts thereafter, or should *"Corn Products* and its progeny," regarded by the Eighth Circuit as "misbegotten," now be overruled?

LIST OF PARTIES

The petitioner is Arkansas Best Corporation and Subsidiaries. All of Arkansas Best Corporation's subsidiaries are wholly owned.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
LIST OF PARTIES	ii
TABLE OF AUTHORITIES	v
OPINIONS BELOW	1
STATEMENT OF JURISDICTION	2
STATUTORY PROVISION INVOLVED	2
STATEMENT OF THE CASE	3
SUMMARY OF THE ARGUMENT	10
ARGUMENT	13
I. THE DECISION OF THE EIGHTH CIRCUIT IS IRRECONCILABLE WITH *CORN PRODUCTS*, IN WHICH THIS COURT REJECTED A LITERAL APPLICATION OF THE STATUTORY DEFINITION OF "CAPITAL ASSET"	13
II. THIRTY YEARS OF JURISPRUDENCE HAS DEMONSTRATED THE EXPEDIENCY AND WORKABILITY OF THE *CORN PRODUCTS* DOCTRINE	21
III. THE EIGHTH CIRCUIT'S REPUDIATION OF THE APPLICATION OF THE *CORN PRODUCTS* DOCTRINE TO CORPORATE STOCK RESTS ON ERRONEOUS REASONING	29
A. The Eighth Circuit's Failure to Follow this Court's Approach to Interpreting Section 1221 Distorts Congressional Intent	29
B. Congress has Recognized and Approved the Operation of the *Corn Products* Doctrine	35

C. Any Administrative Problems Envisioned by the Eighth Circuit Plainly have been Insufficient to Prompt Congress or the Internal Revenue Service to Adopt any Corrective Measures 40

IV. THE PROPER TEST UNDER *CORN PRODUCTS* IS THE DOMINANT MOTIVE TEST 42

CONCLUSION 48

TABLE OF AUTHORITIES

Page

A. Cases

American Automobile Association v. United States, 367 U.S. 687 (1961) 39

Arkansas Best Corporation and Subsidiaries v. Commissioner, 83 T.C. 640 (1984) 1, 5, 6, 7, 27, 28, 29

Arkansas Best Corporation and Subsidiaries v. Commissioner, 800 F.2d 215 (8th Cir. 1986) 1, 8, 9, 10, 24, 30, 34, 40

Barry v. Commissioner, 32 T.C.M. (CCH) 1332 (1973) 26

Bob Jones University v. United States, 461 U.S. 574 (1983) 32

Booth Newspapers, Inc. v. United States, 303 F.2d 916 (Ct. Cl. 1962) 9, 22, 23, 27, 44

Burnet v. Harmel, 287 U.S. 103 (1932) 16, 17

Byram v. United States, 707 F.2d 1418 (5th Cir. 1983) 41

Campbell Taggart, Inc. v. United States, 744 F.2d 442 (5th Cir. 1984) 8, 24, 25, 36

Church of the Holy Trinity v. United States, 143 U.S. 457 (1982) 31

Commissioner v. Brown, 380 U.S. 563 (1965) 39

Commissioner v. Court Holding Co., 324 U.S. 331 (1945) 31

Commissioner v. Duberstein, 363 U.S. 278 (1960) 48

Commissioner v. Ferrer, 304 F.2d 125 (2nd Cir. 1962) .. 19

Commissioner v. Gillette Motor Transport Inc., 364 U.S. 130 (1960) 19, 46

Commissioner v. P.G. Lake, Inc., 356 U.S. 260 1958 19

Commissioner v. Tufts, 461 U.S. 300 (1983) 32

Page

Corn Products Refining Co. v. Commissioner, 350 U.S. 46 (1955) ..... i, 6, 9, 10, 11, 12, 13, 14, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 34, 35, 36, 40, 42, 43, 46, 48, 49

Duffy v. Lethert, 11 AFTR 2d 1317 (D.C. Minn. 1963) 22, 26

Dunn & McCarthy, Inc. v. Commissioner, 139 F.2d 242 (2nd Cir. 1943) 28

Fairbanks v. United States, 306 U.S. 436 (1939) 19

Fink v. Commissioner, 789 F.2d 427 (6th Cir.), *cert. granted*, 107 S.Ct. 454 (1986) 35

First National Bank in Plant City, Florida v. Dickinson, 396 U.S. 122 (1969) 18

F.S. Services, Inc. v. United States, 413 F.2d 548 (Ct. Cl. 1969) 23, 36

Gulftex Drug Co. Inc. v. Commissioner, 29 T.C. 118, *aff'd*, 261 F.2d 238 (5th Cir. 1957) 26

Hagan v. United States, 221 F.Supp. 248 (W.D. Ark. 1963) 22

Helvering v. Winmill, 305 U.S. 79 (1938) 35

Hillsboro National Bank v. Commissioner, 460 U.S. 370 (1983) 32

Hollywood Baseball Association v. Commissioner, 423 F.2d 494 (9th Cir.), *cert. denied*, 400 U.S. 848 (1970) 22

John J. Grier Co. v. United States, 328 F.2d 163 (7th Cir. 1964) 9, 21, 22

Journal Co. v. United States, 195 F.Supp. 434 (E.D. Wis. 1961) 22

Malat v. Riddell, 383 U.S. 569 (1966) 45, 46

Mansfield Journal Company v. Commissioner, 274 F.2d 284 (6th Cir. 1960) 26, 27, 36

Page

McManus v. Commissioner, 65 T.C. 197(1975), *aff'd* 583 F.2d 443 (9th Cir. 1978), *cert. denied*, 440 U.S. 959 (1979) 41

Miller v. Commissioner, 70 T.C. 448 (1978) 26

Norton v. United States, 551 F.2d 821 (Ct. Cl.), *cert. denied*, 434 U.S. 831 (1977) 18

Ozawa v. United States, 260 U.S. 178 (1922) 32

Paulsen v. Commissioner, 469 U.S. 131 (1985) 33

Pittsburgh Reflector Co. v. Commissioner, 27 T.C.M. (CCH) 377 (1968) 22, 25

Ponca Tank v. Commissioner, 26 T.C.M. (CCH) 866 (1967) 26

Roth Steel Tube Co. v. Commissioner, 49 T.C.M. (CCH) 698, *aff'd on another issue*, 800 F.2d 625 (6th Cir. 1986) 26

S.S. Pierce Co. v. United States, 52 AFTR 1700 (D.C. Mass. 1957) 22

Schlumberger Technology Corp. v. United States, 443 F.2d 1115 (5th Cir. 1971) 21, 22, 23, 24, 25

Southeastern Aviation Underwriters Inc. v. Commissioner, T.C.M. (CCH) 412 (1966) 22, 25

Steadman v. Commissioner, 424 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970) 9, 21, 22, 44

Tulane Hardwood Lumber Co. v. Commissioner, 24 T.C. 1146 (1955), *acq;* 1958-1 C.B. 6 22

United States v. American Trucking Association, 310 U.S. 534 (1940) 31

United States v. Generes, 405 U.S. 93 (1972) 46, 48

United States v. Hendler, 303 U.S. 564 (1938) 35

United States v. Klinger, 199 F.2d 645 (2nd Cir. 1952), *aff'd per curiam*, 345 U.S. 979 (1953) 32

United States v. Mississippi Chemical Corporation, 405 U.S. 298 (1972) 29

Page

Waterman, Largen & Co. v. United States, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869 (1970) 22

W.W. Windle Co. v. Commissioner, 65 T.C. 694 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S. 966 (1977) 6, 8, 21, 43, 44, 45

Wright v. Commissioner, 756 F.2d 1039 (4th Cir. 1985) 8, 21

B. Statutes

Internal Revenue Code of 1954 (26 U.S.C.):

Section 162 47

Section 163(d) 26

Section 163(d)(3) 26

Section 165 47

Section 166(a) 47

Section 166(d) 47

Section 183 41

Section 336(a) 32

Section 501(c)(3) 33

Section 1001(b) 32

Section 1221 ..... 2, 9, 12, 13, 14, 17, 18, 19, 20, 21, 25, 29, 30, 33, 34, 36, 37, 39, 40, 41, 42, 46,48

Section 1221(1) 13, 41, 45, 46

Section 1221(2) 13

Section 1221(3) 36

Section 1221(5) 37

Section 1221(6) 37

Section 6213 6

Section 7701(e) 17

Section 7805(b) 44

Page

Internal Revenue Code of 1939 (26 U.S.C.):
Section 117 ..... 2, 13, 14, 15, 16, 17, 18

28 U.S.C. §1254(1) (1966) 2

Bank Holding Company Act Amendments of 1970, Pub.L. No. 91-607, Title I, §103, 84 Stat. 1760 (1970) 4, 27

Economic Recovery Tax Act of 1981, Pub.L. No. 97-34, 95 Stat. 172 (1981) 37

Internal Revenue Code of 1939, Pub.L. No. 76-155, 53 Stat. 862 (1939) 13, 35

Revenue Act of 1924, Pub.L. No. 68-176, 43 Stat. 253 (1924) 17

Revenue Act of 1928, Pub.L. No. 70-562, 45 Stat. 791 (1928) 35

The Tax Reform Act, Pub.L. No. 91-172, 83 Stat. 487 (1969) 36

The Tax Reform Act, Pub.L. No. 94-455, 90 Stat. 1520 (1976) 37

Tax Reform Act of 1986, Pub.L. No. 99-514, 100 Stat. 2085 (1986) 10

C. Federal Rules of Civil Procedure

Rule 52(a) 48

D. Revenue Rulings

Revenue Ruling 75-13, 1975-1 C.B. 7 44

Revenue Ruling 78-94, 1978-1 C.B. 58 44

E. Articles

Brown, "The Growing 'Common Law' of Taxation," 34 *S.Cal. L. Rev.* 235 (1961) 18, 20

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Page

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Miller, "The Unpleasant Taste of *Corn Products*," 53 *S. Cal. L. Rev.* 311 (1979) 36

Natbony, "Whither *Windle*?", 24 *St. Louis U. L. Rev.* 67 (1979) 44

Note, "Judicial Treatment of 'Capital' Assets Acquired for Business: The New Criterion," 65 *Yale L.J.* 401 (1956) 18

Note, "The Troubled Distinction Between Capital Gain and Ordinary Income," 73 *Yale L.J.* 693 (1964) 18

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Troxell & Noall, "Judicial Erosion of the Concept of Securities as Capital Assets," 19 *Tax L. Rev.* 185 (1964) 36

F. Miscellaneous

Arkansas Best Petition for Writ of Certiorari, *Arkansas Best Corporation and Subsidiaries v. Commissioner of Internal Revenue* (No. 86-751) 10

Brief on Petition for Writ of Certiorari for Commissioner of Internal Revenue, *Arkansas Best Corporation and Subsidiaries v. Commissioner of Internal Revenue* (No. 86-751) 10

Brief for Corn Products, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20) 15, 30

Brief for United States, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20) 16

Reply Brief for Corn Products, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20) ..15, 40

Page

Brief for United States, *United States v. Mississippi Chemical Corporation*, 405 U.S. 298 (1972) (No. 71-52) 30

Brief for Appellant and Cross-Appellee, *Arkansas Best Corporation and Subsidiaries v. Commissioner*, 800 F.2d 215 (8th Cir. 1986) (Nos. 85-1702, 85-1818) 7, 8

Brief for Riddell, *Malat v. Riddell*, 383 U.S. 569 (1966) (No. 487) 45

88 Cong. Rec. S 8034-35 (1943) 41

H.R. Rep. No. 1360, 94th Cong., 2d Sess. (1976) 37, 38

H.R. 10902, 94th Cong., 2nd Sess. (1976) 37, 39, 41

Joint Committee on Internal Revenue Taxation, 94th Cong., 1st Sess. *Description of Technical and Minor Bills listed for a Hearing by the Committee on Ways and Means on December 10, 1975* (December 9, 1975) 39

No. 86-751

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ of Certiorari to
the United States Court of Appeals
for the Eighth Circuit

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit (Pet. App.* A-1 — A-12), including the dissenting opinion of Judge Hanson, is reported at 800 F.2d 215 (8th Cir. 1986). The opinion of the United States Tax Court (Pet. App. B-1 — B-28) is reported at 83 T.C. 640 (1984).

* Pet. App. refers to the Appendix to the Petition for Writ of Certiorari herein.

STATEMENT OF JURISDICTION

The judgment of the court of appeals below was entered on September 9, 1986. The petition for writ of certiorari was granted by this Court on March 23, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1) (1966).

STATUTORY PROVISION INVOLVED

26 U.S.C. §1221:[1]

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include —

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for the sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by —

(A) a taxpayer whose personal efforts created such property,

---

[1] Unless otherwise noted, Section references are to the Internal Revenue Code of 1954, as amended, except for references to "Section 117," which is a reference to the Internal Revenue Code of 1939, as amended.

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1);

(5) a publication of the United States Government (including the Congressional Record) which is received from the United States Government or any agency thereof, other than by purchase at the price at which it is offered for sale to the public and which is held by —

(A) a taxpayer who so received such publication, or

(B) a taxpayer in whose hands the basis of such publication is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such publication in the hands of a taxpayer described in subparagraph (A).

STATEMENT OF THE CASE

Arkansas Best Corporation (hereinafter "Arkansas Best") is a diversified holding company based in Fort Smith, Arkansas. In 1968, it owned subsidiaries engaged in trucking, furniture manufacturing, data processing and other businesses. Because its earnings from these operations were highly cyclical, Arkansas Best decided to acquire businesses which could

provide a more stable pattern of earnings over time. One industry which Arkansas Best identified as having this general characteristic was the banking or financial services industry.

In pursuit of this objective, Arkansas Best in 1968 purchased sixty-five percent of the stock of National Bank of Commerce (hereinafter referred to as the "Bank"), then the fourth largest bank in Dallas, Texas. In 1970, however, new Congressional legislation effectively frustrated Arkansas Best's purpose. The Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, Title I, §103, 84 Stat. 1760 (1970) (hereinafter referred to as the "Amendments") prohibited a "one-bank" bank holding company from acquiring new businesses unrelated to banking. Thus, the Amendments would effectively prohibit Arkansas Best — as a "one-bank" bank holding company — from expanding its nonbank businesses, such as trucking or furniture manufacturing, through acquisitions.

The Amendments permitted a company which was unwilling to live with such restrictions to free itself of those restrictions by making a binding commitment to divest its interest in the bank. Such a company was required to file with the Board of Governors of the Federal Reserve System an irrevocable notice of intention to divest its interest in the bank. Arkansas Best filed such a notice on August 1, 1971, and promptly commenced efforts to sell its stock in the Bank.

Public awareness of Arkansas Best's need to sell its Bank stock made it difficult for Arkansas Best to dispose of that stock. Its efforts were made more difficult by increasingly serious financial problems at the Bank. Beginning in 1971, the Office of the Regional Administrator of National Banks made a series of determinations that additional capital had to be raised by the Bank. Despite the fact that on August 1, 1971 the board of directors of Arkansas Best had passed a resolution stating that the company would purchase additional Bank

stock only when absolutely necessary, the deterioration of the financial condition of the Bank forced Arkansas Best to make just such stock purchases from the Bank to provide the additional capital demanded by the regulatory authorities.

Thus, after it filed its notice of intention to divest itself of its Bank stock on August 1, 1971, Arkansas Best made a number of additional purchases of Bank stock ("post-1971 acquisitions"). It did so in an effort to prevent the imposition of sanctions — including a possible closing of the Bank — by the regulatory authorities.[2] Such sanctions would have severely damaged Arkansas Best's reputation as a responsible, competently managed, diversified holding company, as well as its banking and financial relationships.

As to all of these post-1971 acquisitions of Bank stock, Arkansas Best suffered undisputed losses when it finally was able to sell its interest in the Bank beginning in 1975. Arkansas Best sought to deduct these losses from its income as ordinary losses.[3] The Commissioner of Internal Revenue disallowed such deductions, characterizing them as capital losses. Such capital

---

[2] Two small acquisitions of stock were made for other reasons, one in connection with an employment dispute, which the Tax Court found to be business motivated, 83 T.C. at 657; Pet. App. at B-21, and another in connection with insurance regulatory requirements. *See* discussion at fn. 4, *infra* at p. 7.

[3] Arkansas Best also sought to deduct as an ordinary item the losses incurred on sales of Bank stock acquired in 1968 and 1969. The Tax Court held that losses on sales of all Bank stock acquired prior to 1973 were capital losses. 83 T.C. at 655; Pet. App. at B-19. Arkansas Best appealed the decision of the Tax Court to the Eighth Circuit Court of Appeals only with respect to the proper characterization of the losses incurred on the sales of the post-1971 acquisitions. Accordingly, the character of the losses incurred on the Bank stock acquired in 1968 and 1969 is no longer an issue in this case.

losses are not deductible against the ordinary income of a corporation, but may be used only to offset capital gains.

Arkansas Best challenged the Commissioner's deficiency determination in the United States Tax Court, which had jurisdiction over the action under Section 6213 (26 U.S.C. §6213). After a full trial, Judge Nims of the Tax Court found as a threshold matter that Arkansas Best, as a holding company, was engaged in the "trade or business defined as the acquisition and management of going concerns in diverse yet complementary lines of business." 83 T.C. at 653; Pet. App. at B-16. Judge Nims went on to make findings of fact regarding Arkansas Best's purposes in making its post-1971 acquisitions of Bank stock. With respect to the stock acquired by Arkansas Best prior to 1973, the Tax Court found that such purchases "were motivated primarily by investment purposes and only incidentally by some business purpose." 83 T.C. at 654; Pet. App. at B-18. Based upon this Court's decision in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955), and its own decision in *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S. 966 (1977), the Tax Court held that Arkansas Best's losses on the sale of such stock were capital losses. 83 T.C. at 655; Pet. App. at B-19.

As to Bank stock acquired after 1972, the Tax Court found that "[t]hese later purchases were made exclusively for business purposes and subsequently held for the same reasons." 83 T.C. at 656; Pet. App. at B-20. In particular, the Court held:

> Expenditures to preserve business reputation are typically currently deductible business expenses . . . . The purchase of stock may be a necessary tactic in the protection of business reputation, and in certain narrow circumstances may invoke the doctrine of *Corn Products*.
>
> • • •

> [Arkansas Best] carried through on a losing proposition solely to preserve its business reputation and therefore we hold that it is entitled to an ordinary loss on the disposition of NBC shares acquired in the years 1973 through 1976.

83 T.C. at 656-57; Pet. App. at B-20-21.

Arkansas Best appealed from the Tax Court's finding as to the purpose of the 1972 purchases of Bank stock.[4] Arkansas Best argued that these purchases, like those made after 1972, were motivated by business purposes, and not by investment purposes. Among other things, Arkansas Best pointed out the undisputed evidence that it irrevocably had committed itself to sell all of its Bank stock in 1971, and was engaged actively in efforts to accomplish such a divestiture throughout 1972. Its purchases of stock in response to capital calls in 1972 therefore were not part of any effort to invest in such stock in order to realize a profit, but were made to protect its business reputation by maintaining the solvency of the Bank.

The Commissioner, however, appealed from the Tax Court's holding that the losses resulting from the sales of Bank stock purchased after 1972 were ordinary losses. The Commissioner

---

[4] Arkansas Best also appealed the decision of the Tax Court that it was not entitled to an ordinary loss in connection with the sale of the Bank stock acquired by Arkansas Best from its subsidiary, Universal Insurance Company ("Universal"). The Tax Court based its decision on an erroneous reading of a stipulation. 83 T.C. at 657; Pet. App. at B-21. The Government has conceded that the Tax Court's interpretation of the stipulation was incorrect, but nevertheless continues to claim that such stock was a capital asset. Brief for Appellant and Cross-Appellee at 9, fn. 8, *Arkansas Best Corporation and Subsidiaries v. Commissioner*, 800 F.2d 215 (8th Cir. 1986) (Nos. 85-1702, 85-1818).

did not directly challenge the Tax Court's factual findings that the post-1972 stock purchases were made solely for business purposes and with no investment purpose whatsoever. He argued instead that "[t]he findings of fact of the Tax Court demonstrate that the [Bank] stock was never integral to the 'complementary group' of businesses carried on by the taxpayer and its subsidiaries." Brief for the Appellant and Cross-Appellee at 12, *Arkansas Best Corporation and Subsidiaries v. Commissioner*, 800 F.2d 215 (8th Cir. 1986) (Nos. 85-1702, 85-1818). The Commissioner contended that the losses resulting from purchases of Bank stock could be treated as ordinary losses only if such stock was "integral" to the business of Arkansas Best.

The Eighth Circuit Court of Appeals, on September 9, 1986, held that all of the losses suffered by Arkansas Best as a result of sales of the Bank stock were capital losses, and hence nondeductible against ordinary income. 800 F.2d 215 (8th Cir. 1986). Speaking for a divided court, Judge Bowman concluded that corporate stock does not fall within the language of any exclusion from the statutory definition of "capital asset." Accordingly, the court of appeals held that corporate stock not held by a securities dealer always is a capital asset, regardless of the purposes for its acquisition or retention or any surrounding factual circumstances. Under this holding, the Tax Court's findings as to Arkansas Best's purposes in acquiring the Bank stock were irrelevant, even though unchallenged.

The majority opinion expressly and necessarily rejected contrary holdings of the Courts of Appeals for the Fourth and Fifth Circuits, the Tax Court, and the Court of Claims.[5] Each

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[5] *Wright v. Commissioner*, 756 F.2d 1039 (4th Cir. 1985); *Campbell Taggart, Inc. v. United States*, 744 F.2d 442 (5th Cir. 1984); *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S.

of these cases, and similar decisions of the Courts of Appeals for the Sixth and Seventh Circuits,[6] had applied this Court's decision in *Corn Products* to hold that transactions in corporate stock could give rise to ordinary gain or loss under certain circumstances. In criticizing these decisions, the majority opinion of the court of appeals below referred to "*Corn Products* and its progeny, which we respectfully view as misbegotten." 800 F.2d at 221; Pet. App. at A-10. It stated:

> We do not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221.

Id.

The court of appeals offered two brief reasons for its holding. Most significant to the court was its conclusion that corporate stock is not within the language of any statutory exclusion to the definition of "capital asset," regardless of the taxpayer's motives for acquiring and holding that stock. 800 F.2d at 220; Pet. App. at A-9. The majority opinion argued that Congress might have written such an explicit exception regarding corporate stock, but had not, and asserted that "the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make." *Id.* The Eighth Circuit further argued that *Corn Products* and its progeny had fostered "subjectivity and uncertainty" in the tax code, "leading to increased recourse to the administrative and judicial processes to resolve conflicting contentions about taxpayers' intentions in purchasing capital stock." *Id.*

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966 (1977); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962).

[6] *Steadman v. Commissioner*, 424 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970); *John J. Grier Co. v. United States*, 328 F.2d 163 (7th Cir. 1964).

In a dissenting opinion, Judge Hanson expressed his view that the losses suffered by Arkansas Best on stock acquired after 1972 were ordinary losses. After noting that "*Corn Products* was merely an attempt to divine congressional intent," 800 F.2d at 221; Pet. App. at A-11, Judge Hanson stated:

> [C]onsistent with *Corn Products*, the stock was purchased as an integral and necessary act in the conduct of Arkansas Best's business as a holding company.

Id. at 222; Pet. App. at A-11-12.

Arkansas Best thereafter filed its petition for writ of certiorari, pointing out the lack of precedent for the decision of the court of appeals, the conflicts among the circuits, the Tax Court, and the Court of Claims created by the decision of the court of appeals below, and the continuing importance of the issues presented.[7] The Commissioner concurred in the petition. This Court granted the petition for writ of certiorari on March 23, 1987.

SUMMARY OF THE ARGUMENT

The decision of the Eighth Circuit Court of Appeals in this case is fundamentally inconsistent with *Corn Products Refining*

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[7] As both Arkansas Best and the Government have noted, the capital/ordinary distinction will have continued significance for the taxation of both gains and losses throughout the Internal Revenue Code, despite the fact that under the changes effected by the Tax Reform Act of 1986, Pub. L. No. 99-514, § 301, 311, 100 Stat. 2085 (1986), ordinary income will be subject to the same maximum rate of tax as capital gains. Arkansas Best Petition for Writ of Certiorari at 20-21, *Arkansas Best Corporation and Subsidiaries v. Commissioner of Internal Revenue* (No. 86-751); Brief on Petition for Writ of Certiorari for Commissioner of Internal Revenue at 14, *Arkansas Best Corporation and Subsidiaries v. Commissioner of Internal Revenue* (No. 86-751).

Company v. Commissioner, 350 U.S. 46 (1955). In *Corn Products*, this Court rejected a literal application of the statute defining "capital asset" in favor of a standard intended to distinguish between assets acquired and held in connection with the taxpayer's usual trade or business and those acquired principally for investment. Such a standard far more correctly reflects the purpose of Congress in this important area of the tax law, and prevents the absurd and unintended results that otherwise would obtain. Accordingly, an evaluation of the taxpayer's motives and business circumstances is essential under *Corn Products*, and an asset cannot be classified as "capital" without regard to the factual circumstances of the particular case under consideration.

In this case, the Eighth Circuit refused to apply the principles of *Corn Products*, suggesting that the sole permissible inquiry was whether corporate stock falls within the language of any specific exclusion to the statutory definition of "capital asset." The majority opinion of the court of appeals eschewed any consideration of the facts surrounding the acquisition by Arkansas Best of the Bank stock at issue, holding in essence that corporate stock is always a capital asset (unless held by a securities dealer), regardless of the reasons for which it is acquired by a taxpayer. Because the Eighth Circuit's ruling cannot be reconciled with this Court's controlling decision in *Corn Products*, the ruling of the court of appeals must be reversed.

This conclusion is reinforced by an examination of the many cases applying the *Corn Products* doctrine over the last thirty years. Prior to the decision of the Eighth Circuit in this case, the courts unanimously had held that the tax consequences in such cases were not dictated by the kind of asset, but by the purposes of the individual taxpayer for acquiring and holding the asset. Corporate stock therefore was held in numerous

cases to constitute an "ordinary" asset, even though that result could not have been reached based on the statutory language alone. The law, as set forth in *Corn Products* and the many cases applying it since 1955, clearly requires the same result in this case, based on the unchallenged factual findings of the Tax Court.

The majority opinion below not only is unfaithful to *Corn Products* and contrary to all subsequent judicial authority, but is based upon faulty judicial reasoning. A court best carries out its duty in interpreting a statute by determining and effectuating the intent of Congress, and not by a mere mechanical reading of the words of the statute. Here, this conclusion is fortified by extensive evidence that Congress is aware of and approves the *Corn Products* doctrine, and by the illogical and unintended results that necessarily would flow from a literalistic reading of the statute.

The extensive judicial authority applying the doctrine, and the rejection by Congress of legislation that would have changed it or added administrative requirements for its invocation, likewise refute the only other rationale offered by the Eighth Circuit for its unprecedented decision. Contrary to the suggestion of the majority opinion, the *Corn Products* doctrine has proved workable, and has not created unmanageable demands on administrative or judicial processes. An examination of the subjective motivations of taxpayers is a familiar and inevitable part of applying Section 1221, as well as many other tax provisions, and certainly provides no justification for jettisoning *Corn Products* and thirty years of subsequent authority.

The proper standard for determining whether corporate stock is a capital asset is the "dominant business motive" test. Under this test, stock will not be regarded as a capital asset if the dominant or primary motive for acquiring the stock is

related to the taxpayer's business, rather than to earn an investment profit. The adoption of this standard is counselled by this Court's past decisions and will prove superior in practice to the alternative "absence of substantial investment motive" test. Under the correct standard, Arkansas Best is entitled to ordinary loss treatment with respect to its losses on sales of Bank stock acquired after 1971.

ARGUMENT

I. THE DECISION OF THE EIGHTH CIRCUIT IS IRRECONCILABLE WITH *CORN PRODUCTS*, IN WHICH THIS COURT REJECTED A LITERAL APPLICATION OF THE STATUTORY DEFINITION OF "CAPITAL ASSET"

Over thirty years ago, this Court unanimously held in *Corn Products* that corn futures contracts acquired as an integral part of the taxpayer's everyday business operations constituted non-capital assets. The Court so held without regard to the fact that identical futures contracts held by an *investor* undoubtedly would have been capital assets. Moreover, that conclusion was reached despite the Court's express acknowledgement that its decision could not be justified by the literal language of the statutory provision defining "capital asset."[8] In effect, this Court recognized that a proper application of the capital asset definition as understood by Congress requires an analysis which reaches beyond the literal terms of the statute, and instead focuses on the circumstances surrounding the use to which the property is to be put by the taxpayer.

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[8] The relevant statutory language set forth in Section 117 of the Internal Revenue Code of 1939, Pub. L. No. 76-155, 53 Stat. 862 (1939), and considered by this Court in *Corn Products* is virtually identical to the language now contained in Section 1221(1) and (2).

The factual circumstances and legal arguments presented to this Court in *Corn Products* confirm the need to go beyond a literal interpretation of Section 1221 in order to effect the intent of Congress. Corn Products Refining Company (hereinafter referred to as the "Company") was engaged in the business of manufacturing various products from corn, such as starch and sugar. The Company was unable to maintain substantial supplies of corn on hand due to its limited storage capacity. In order to avoid a price squeeze if it were required to purchase corn on the open market at prices in excess of that which it had assumed in setting fixed prices for future deliveries, the Company purchased corn futures contracts. The Company would take delivery on these contracts when necessary to maintain an adequate supply of corn at a predetermined price. As a result, if a corn shortage occurred, it would be protected against a price increase. If no shortage occurred, the contracts were sold. The issue considered by the lower courts and presented to this Court for review was whether gains on the sales of the futures contracts in this factual context were capital gains or ordinary income. This Court concluded that because the profits from the sales of the futures contracts were related to the everyday business operations of the Company, they were required to be treated as ordinary income. 350 U.S. at 52.

An examination of the arguments made by the taxpayer and the Government in *Corn Products* demonstrates that this Court's opinion represented a deliberate decision to look beyond the literal language of the statutory exceptions set forth in Section 117 (the predecessor to Section 1221) to the policy of the statute. In reaching that conclusion, this Court considered, and rejected, the arguments of the Company that corn futures contracts were required to be treated as capital assets simply because they did not fall within any of the statutory exceptions under Section 117. *See* Brief for Corn Products at

11, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20) [hereinafter cited as "Brief for Corn Products"]. According to the Company, the exclusions under Section 117 were comprehensive; it felt that Congress, in setting forth these exceptions had addressed itself "specifically, . . . unambiguously, and . . . comprehensively" to the problem of defining a capital asset. Brief for Corn Products at 15. The Company argued: "Where a statute sets up a general rule and enumerates specific exceptions, as a matter of statutory construction further exceptions by way of *mere implication* are not permissible." Reply Brief for Corn Products at 4, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20) [hereinafter cited as "Reply Brief for Corn Products"]. Moreover, the Company warned that the test applied by the Tax Court in that case — whether futures contracts were an integral part of the taxpayer's manufacturing business — not only ignored the literal language of Section 117, but was an amorphous standard that was nothing less than the rankest sort of judicial legislation. Brief for Corn Products at 32, 33. Only "great uncertainty in the administration and application of the capital limitations" would result from a focus on the purpose or intent of the taxpayer rather than the statutory language. Reply Brief for Corn Products at 28.

The arguments of the Company in favor of a literal interpretation of the statute were countered by equally emphatic arguments to the contrary by the Government. The Government argued that the exceptions under Section 117 simply were evidence of the intent of Congress that profits or losses from everyday business activities are not to be accorded the special treatment reserved for capital assets.

> [W]e disagree with the conclusion that taxpayer draws, namely, that since the futures contracts do not come within the precise words of the enumerated exceptions, they must be classified as capital assets.

Brief for United States at 19, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20) [hereinafter cited as "*Corn Products* Brief for United States"].

Instead, the Government argued that the purpose of the transaction should be determinative of whether the asset should be classified as a capital asset. *Id.* at 13, 31. The Government concluded that since the purpose of the purchase of the corn futures contracts was to provide price protection and to ensure an adequate supply of corn in excess of the Company's limited storage capacity, both of which were related to taxpayer's ordinary business activities, the gains resulting from the transactions in the corn futures contracts should be treated as ordinary income. As summarized by the Government in its brief, "It is therefore essential to examine the nature of taxpayer's transactions in commodities futures in the context of the over-all operations of its manufacturing business." *Id.* at 31.

The unanimous opinion of this Court made it clear that its conclusion was compelled not by any mechanical application of the statutory language, but by its firm understanding of the purpose of Congress in enacting the statute.

> Admittedly, petitioner's corn futures do not come within the literal language of the exclusions of [Section 117] .... But the capital-asset provisions of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. Burnet v. Harmel, 287 U.S. 103, 108, 53 S.Ct. 74, 76, 77 L.Ed. 199. Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than

> capital gain or loss. The preferential treatment provided by §117 applies to transactions in property which are not the normal source of business income. It was intended "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." Burnet v. Harmel, 287 U.S. at page 106, 53 S.Ct. at page 75. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose.

350 U.S. at 51-52.

Thus, this Court chose to view the categories of exclusions as indicia of the type of property that Congress intended to exclude.[9] The common thread which the Court saw running

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[9] The conclusion that the exceptions set forth in Section 1221 are merely examples of the type of assets which are excluded from the definition of capital asset is confirmed by the Internal Revenue Code. Like its predecessor Section 117, Section 1221 only defines "capital asset" by enumerating assets that are not capital assets. Section 7701(c) provides that:

> "includes" and "including" when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.

This instruction has been contained in the Code in substantially the same form since 1924. *See* Section 2(b) of the Revenue Act of 1924, Pub. L. No. 68-176, 43 Stat. 253 (1924). Thus, in Section 1221, which effectively defines the term "noncapital asset," the five exceptions are clearly not meant to be an exhaustive list. If Congress had intended for this list to be exclusive, it would have used a word such as "except," rather than "include." As this Court previously has noted "use of the word 'include' . . . suggests a calculated indefiniteness with respect to the outer limits of the

through those exclusions was that they distinguish between transactions which arise from "everyday operations of a business" and those which arise from the activities of a "legitimate capitalist." 350 U.S. at 49, 52. *See* Note, "The Troubled Distinction Between Capital Gain and Ordinary Income," 73 *Yale L. J.* 693 (1964). Because the business purposes of the taxpayer in *Corn Products* were such that its corn futures profits were akin to "profits arising from the everyday operation of a business," the Court held them to be ordinary gains taxable at a much higher rate than that applicable to capital gains.

While this Court's decision has been criticized by some commentators for looking beyond the specific statutory exclusions to the capital asset definition,[10] the decision was plainly appropriate given the unintended breadth of the definition of capital asset as set forth in Section 117.[11] *Corn Products* and its progeny represent those courts' recognition of

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term [defined]." *First National Bank in Plant City, Florida v. Dickinson*, 396 U.S. 122, 135 (1969). This Congressionally mandated rule of construction confirms the validity of this Court's decision to look beyond the statutory exclusions of Section 117 to that section's intended purpose.

[10] *See, e.g.*, Freeman, "Is There a New Concept of Business Asset?", 36 *Taxes* 110 (1958); Kauffman, "A Second Look at the *Corn Products* Doctrine," 41 *Taxes* 605 (1963); Brown, "The Growing 'Common Law' of Taxation," 34 *S. Cal. L. Rev.* 235 (1961); Note, "Judicial Treatment of 'Capital' Assets Acquired for Business: The New Criterion," 65 *Yale L. J.* 401 (1956).

[11] This Court has approached in numerous ways the issues presented by the broad approach adopted by Congress in defining a "capital asset" in Section 1221. As the Court of Claims noted in citing a passage from Eustice, "Contract Rights, Capital Gain, and Assignment of Income — the *Ferrer* Case," 20 *Tax L. Rev.* 1 (1964), in *Norton v. United States*, 551 F.2d 821, 826 fn. 17 (Ct. Cl.), *cert. denied*, 434 U.S. 831 (1977):

> the failure of Congress to face up realistically to the classification problem inherent in the attempted division between "investment" and "business."... [T]herefore [Congress] did not desire to be taken literally when it used the broad term "property" in section 1221. The courts are willing to rescue Congress from its statutory strait jacket.

Surrey, "Definitional Problems in Capital Gains Taxation," 69 *Harv. L. Rev.* 985, 995-96 (1956) [hereinafter cited as "Surrey"].

The approach used by Congress in defining "capital asset" was to include all "property" as capital assets, but then to exclude various types of property. In *Corn Products*, this Court recognized that this broad definition if literally applied would create results contrary to the intent of Congress: profits arising from normal everyday transactions, such as the Company's corn futures activities, would qualify for preferential capital gains treatment, rather than receive the ordinary income treatment they deserve. To avoid such unintended results, this Court understandably chose to be guided by the purpose of Section 1221, rather than its literal terms. In effect, the Court

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The approaches may be grouped into certain broad categories: (1) Is the asset "property" which is a "capital asset" under Section 1221? See *Commissioner v. Gillette Motor Transport Inc.*, 364 U.S. 130 (1960); *Comm'r v. Ferrer, supra* note 16; (2) Do the amounts received by the taxpayer upon the sale of the contract rights represent a substitute for future ordinary income that otherwise would have been received by the taxpayer? See *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260 (1958); *Commissioner v. Ferrer, supra*; (3) Does the transaction constitute a "sale or exchange"? See *Fairbanks v. United States*, 306 U.S. 436 (1939); (4) Was the property acquired with an intention that it would serve an integral function in the taxpayer's regular business activities? See *Corn Products Refining Co. v. Commissioner, supra* note 9.

recognized that to limit itself to a purely literal reading of the words before them was "both inadequate and harmful, at least until the literary skill and the imagination of our legislative draftsman go far beyond their present development." Brown, "The Growing 'Common Law' of Taxation," 34 *S. Cal. L. Rev.* 223, 236 (1961). Viewed in this light, it is eminently justifiable that this Court deliberately fashioned its opinion in *Corn Products* as a vehicle to properly effectuate the intent of Congress in differentiating between capital and ordinary assets.

These, then, are the two principles which are at the heart of *Corn Products*, and which have been the touchstone for the extensive development of the tax law in this area for three decades. First, ordinary versus capital treatment depends not upon a talismanic application of the wording of Section 1221, but upon a determination as to whether that characterization will further the purpose of Congress: to distinguish between transactions related to everyday business operations and transactions which are "not the normal source of business income." 350 U.S. at 52. Second, that crucial determination necessarily depends upon the purposes and circumstances of the taxpayer in each case — was the asset acquired to accomplish a business objective of the taxpayer? The same asset which is a source of ordinary business income for one taxpayer may be the object of a once-in-a-lifetime investment for another.

The decision of the Eighth Circuit Court of Appeals in this case is fundamentally at odds with the essential principles of *Corn Products*. Indeed, the court of appeals suggested that the continuing validity of *Corn Products*, and its application beyond the facts of that case, was in doubt. Although the majority opinion did not make explicit whether it viewed only the "progeny" of *Corn Products* as "misbegotten," or *Corn Prod-*

ucts itself, there can be little question that the court of appeals chose not to apply fully and fairly the Court's decision in *Corn Products* in this case.

Because it was the duty of the court of appeals to follow the controlling precedents of this Court, this itself was error. If *Corn Products* is still the law, a decision based upon the proposition that all property necessarily is a "capital asset" unless it falls within a specific exclusion to the definition of that term in Section 1221 simply cannot stand. Thus, the central issue before the Court is *not* whether the decision of the Eighth Circuit is consistent with *Corn Products*; it plainly is not. It is whether this Court should now overrule *Corn Products* and retreat from the principles on which it was based. Arkansas Best respectfully submits that *Corn Products* was decided correctly, reflects the intention of Congress as fully today as it did in 1955, and should now be reaffirmed.

II. THIRTY YEARS OF JURISPRUDENCE HAS DEMONSTRATED THE EXPEDIENCY AND WORKABILITY OF THE *CORN PRODUCTS* DOCTRINE

The correctness of this Court's decision in *Corn Products* is underscored by thirty years of unimpeached case law. Six circuit courts, the Court of Claims, the Tax Court and numerous district courts have employed the *Corn Products* doctrine to loosen the "statutory strait jacket" into which the literal language of Section 1221 has placed the essentially factual distinction between capital and ordinary assets.[12] These courts

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[12] *W.W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S. 966 (1977); *Wright v. Commissioner*, 756 F.2d 1039 (4th Cir. 1985); *Schlumberger Technology Corp. v. United States*, 443 F.2d 1115 (5th Cir. 1971); *Steadman v. Commissioner*, 424 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970); *John J. Grier Co. v.*

have not hesitated in applying to a wide variety of factual situations the principle that assets acquired and retained to serve a function integral to the everyday operation of a business should not receive treatment as a capital asset. In the vast majority of these cases, the asset acquired has been corporate stock.[13] A brief review of some of these cases illustrates the practical and theoretical soundness of the doctrine.

United States, 328 F.2d 163 (7th Cir. 1964); *Hollywood Baseball Association v. Commissioner*, 423 F.2d 494 (9th Cir.), *cert. denied*, 400 U.S. 848 (1970); *Waterman, Largen & Co. v. United States*, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869 (1970); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962); *Tulane Hardwood Lumber Co. v. Commissioner*, 24 T.C. 1146 (1955), *acq.*, 1958-1 C.B. 6; *Pittsburgh Reflector Co. v. Commissioner*, 24 T.C.M. (CCH) 377 (1968); *Hagan v. United States*, 221 F.Supp. 248 (W.D. Ark. 1963); *Duffy v. Lethert*, 11 AFTR 2d 1316 (D.C. Minn. 1963); *Journal Co. v. United States*, 195 F.Supp 434 (E.D. Wis. 1961); *S. S. Pierce Co. v. United States*, 52 AFTR 1700 (D.C. Mass. 1957).

[13] For example, the *Corn Products* doctrine has been applied where stock or securities were acquired to assure continued business or employment relationships with the issuer of the stock, *Steadman v. Commissioner*, 425 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970) (stock acquired to protect taxpayer's position as general counsel); *Southeastern Aviation Underwriters Inc. v. Commissioner*, 25 T.C.M. (CCH) 412 (1966) (stock acquired to obtain a contract); *Waterman, Largen & Co. v. United States*, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869 (1970) (stock acquired to preserve an exclusive sales agency), to obtain the use of a valuable asset or the expertise of personnel of the issuing corporation, *John J. Grier Co. v. United States*, 328 F.2d 163 (7th Cir. 1964) (stock in a corporation acquired to obtain a lease held by the corporation); *Schlumberger Technology Corp. v. United States*, 443 F.2d 1115 (5th Cir. 1971) (stock acquired to obtain the services of a highly skilled team of scientists), to reduce import taxes and assembly costs, *Pittsburgh Reflector Co. v. Commissioner*, 27 T.C.M. (CCH) 377 (1968), and to obtain a source of supply, *Booth Newspapers, Inc. v.*

In *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962), a newspaper publisher, suffering through a severe shortage in the supply of newsprint, bought the stock of a small newsprint mill to provide it with newsprint until its regular sources of supply could be reestablished. When the shortage ended, the stock was sold at a loss. The Court of Claims found that the stock purchase was a reasonable method to solve what was a vital business problem. Although the stock did not literally fall within any of the exclusions to the capital asset definition, it clearly was purchased as "an integral and necessary act in the conduct of the taxpayer's business," *id.* at 921, and deserved treatment as an ordinary loss. By no stretch of the imagination could this purchase have been characterized as the action of a "legitimate capitalist." *Corn Products*, 350 U.S. at 51. However, absent this Court's decision in *Corn Products*, only such an illogical result would have been possible.

The Fifth Circuit Court of Appeals also has applied and developed the *Corn Products* principles as a workable method to effectuate the intended distinction between capital and ordinary assets. In *Schlumberger Technology Corp. v. United States*, 443 F.2d 1115 (5th Cir. 1971), a corporation engaged in measuring physical phenomena purchased a controlling portion of the stock of a computer firm in an attempt to integrate much-needed computer expertise into its measurement system. When the computer firm lost its value, the stock was sold at a loss. The corporation then bought the stock of a second computer firm with the primary intention of obtaining market know-how, a unique research team and possibly some military systems contracts. The second firm subsequently went bankrupt.

United States, 303 F.2d 916 (Ct. Cl. 1962) (newsprint); *F. S. Services, Inc. v. United States*, 413 F.2d 548 (Ct. Cl. 1969) (petroleum products).

In evaluating the character of these two stock purchases, the Fifth Circuit found that both purchases were necessary and integral to the taxpayer's everyday business and that the stock was not purchased for any investment purposes in either instance. The Fifth Circuit rejected two tests suggested by the Government that would have artificially limited the application of the *Corn Products* doctrine. The first, the "temporary expedient" test, would have required the asset to be necessary to acquire inventory or protect a source of supply. The second, the "protection-expansion" test, would have denied ordinary treatment to assets purchased to expand as opposed to protect an existing business. The Fifth Circuit found both tests to be derived from unreasonably mechanical readings of prior case law. *Schlumberger*, 443 F.2d at 1121.

In *Campbell Taggart, Inc. v. United States*, 744 F.2d 442 (5th Cir. 1984), the case the Eighth Circuit cited as "most closely analogous to the one before us," 800 F.2d at 220; Pet. App. at A-9, a holding company of food products, marketing and storage businesses agreed to purchase the stock of a Spanish supermarket chain. When the chain's financial condition worsened, the terms of the purchase agreement allowed the holding company to terminate its obligation to buy the supermarket chain. However, in order to protect its goodwill and reputation as a manager of food operations, the holding company concluded that it was in its best interest to complete the purchase of the stock, but with the intention to sell it immediately. The stock ultimately was sold at a loss.

On these facts, the Fifth Circuit reasoned that since expenditures to protect existing goodwill and business reputation are deductible business expenses, stock acquired for the same purpose was entitled to ordinary asset treatment. Moreover, the court employed a list of objective factors and characteristics derived from prior *Corn Products* cases to assist in its

"facts and circumstances" analysis of the taxpayer's motives: the needs of the taxpayer's business, the length of time the asset was held, the nature of the taxpayer's other business and investment activities, the resulting business and investment advantages that might reasonably be expected to flow from the acquisition or expenditure, and the taxpayer's statements of its subjective intent at the time of acquisition and disposition. 744 F.2d at 458. The Fifth Circuit, in setting forth this list of objective factors, stated that it did not intend to

> place ordinary or capital treatment at the whim of the taxpayer. We are acutely aware of the possibility that a taxpayer's recollection of his intent at the time an asset was acquired may be colored by whether he ultimately recognizes gain or loss upon disposition of the asset. . . . [W]e are confident that courts can, by evaluating the objective factors outlined above, continue to avoid the whipsaw potential that reliance upon subjective intent might well create.

Id. As both *Schlumberger* and *Campbell Taggart* illustrate, the *Corn Products* doctrine has evolved and gained clarification with each application.

The Tax Court also has employed widely the principles of this Court's decision in *Corn Products*. The Tax Court has embraced the *Corn Products* doctrine on numerous occasions for determining whether stock is an ordinary or capital asset under Section 1221. *See, e.g., Southeastern Aviation Underwriters, Inc. v. Commissioner*, 25 T.C.M. (CCH) 412 (1966) (stock of Canadian company purchased to enable shipping of parts at savings on freight costs and duties); *Pittsburgh Reflector Company v. Commissioner*, 27 T.C.M. (CCH) 377 (1968) (stock purchased to obtain aviation insurance management contract to replace lost insurance business). Moreover, in an analogous area, the Tax Court has found these principles equally appro-

priate in distinguishing between investment and business loans in applying the investment interest limitations of Section 163(d).[14] *See Miller v. Commissioner*, 70 T.C. 448 (1978).

The establishment and evolution of the *Corn Products* doctrine in the lower courts has not spurred a rash of victories by taxpayers. Rather, taxpayers have lost their fair share of cases involving the characterization of corporate stock. *See, e.g.*, *Roth Steel Tube Co. v. Commissioner*, 49 T.C.M. (CCH) 698, *aff'd on another issue*, 800 F.2d 625 (6th Cir. 1986) (shareholder bought stock to combine operations but had substantial investment motive); *Gulftex Drug Co. Inc. v. Commissioner*, 29 T.C. 118, *aff'd*, 261 F.2d 238 (5th Cir. 1957) (purchase and retention of stock to obtain whiskey rights held for many years was investment-motivated); *Barry v. Commissioner*, 32 T.C.M. (CCH) 1332 (1973) (employer's stock not purchased to save taxpayer's job); *Duffy v. Lethert*, 11 AFTR 2d 1317 (D.C. Minn. 1963) (purchaser of stock looked to future gain and was investment motivated); *Ponca Tank v. Commissioner*, 26 T.C.M. (CCH) 866 (1967) (taxpayer could not show that stock purchase to acquire captive customer for storage tanks was not for investment).

In addition, the results reached by the courts, prior to this case, have generally been consistent with one another, regardless of whether a gain or loss is involved. For example, in *Mansfield Journal Company v. United States*, 274 F.2d 284 (6th Cir. 1960), the gain on the sale of contract rights that were originally obtained to secure a needed supply of newsprint was

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[14] Section 163(d) disallows any deductions for "investment interest" expenses incurred to the extent they are in excess of investment income. "Investment interest" generally means any interest which is paid or accrued on indebtedness incurred or continued to purchase or carry property held for investment. Section 163(d)(3).

held to be an ordinary gain. The principles of the decision in *Mansfield* were adhered to by the Court of Claims in *Booth Newspapers*, *supra*, in which the taxpayer purchased stock in a mill to accomplish the same objective. Although *Booth Newspapers* was a loss case, the two courts' *Corn Products* analyses yielded the same conclusion of ordinary asset treatment.

The principles enunciated in *Corn Products* and its progeny requiring ordinary asset treatment where corporate stock is acquired for a business purpose are properly applicable to the facts before the Court in this case. Arkansas Best is a holding company which is "the nucleus of a diversified conglomerate with subsidiaries engaged in the business of transportation, consumer goods and financial services." 83 T.C. at 650; Pet. App. at B-12. After acquiring a controlling interest in the Bank in 1968, Congress passed the Amendments in 1970, thereby forcing Arkansas Best to choose between continuing to make acquisitions of nonbanking businesses or divesting itself of the Bank stock. Given the nature of its business as an acquisitive conglomerate, Arkansas Best chose the latter course of action. As a result of this irrevocable commitment by Arkansas Best to divest its Bank stock, this case presents an unusually clear instance of stock acquisitions (the post-1971 acquisitions) which were not, and could not have been, motivated by the hope of reaping an investment profit.

Before Arkansas Best could find a purchaser for its interest in the Bank, the financial condition of the Bank began to deteriorate rapidly. 83 T.C. at 656; Pet. App. at B-20. In light of these economic difficulties, Arkansas Best responded to the Bank's need for substantial capital infusions by acquiring additional Bank stock, knowing full well that it could not hope for profit on these purchases, and that its failure to do so would have resulted in the demise of the Bank. *Id.* Arkansas Best responded as it did because it was well aware of the special

responsibility imposed upon it as the controlling shareholder of the Bank — "a peculiarly public institution." *Id.*

As the Tax Court pointedly concluded:

> As a growing conglomerate, Arkansas Best depended upon its good reputation with creditors in order to assure a reliable source of financing for acquisitions. In addition, Arkansas Best's reputation as a conglomerate especially skilled in management determined its standing with other businessmen and in the stock market. (Arkansas Best was listed on the American Stock Exchange beginning in 1969 and on the New York Stock Exchange beginning in 1972.) Association with the failure of a bank would have severely blemished Arkansas Best's reputation in the financial and business communities in which it operates.
>
> Moreover, the demise of the bank would have exposed Arkansas Best (as controlling shareholder) to potentially damaging and costly litigation by minority shareholders.
>
> Expenditures to preserve business reputation are typically currently deductible business expenses. *Dunn & McCarthy, Inc. v. Commissioner*, 139 F.2d 242 (2d Cir. 1943). The purchase of stock may be a necessary tactic in the protection of business reputation, and in certain narrow circumstances may invoke the doctrine of *Corn Products*.
>
> Arkansas Best was not compelled to make purchases of NBC stock after 1972 nor could it have been motivated by the prospect of obtaining a profitable return on its purchases. The conglomerate carried through on a losing proposition solely to preserve its business reputation and therefore we hold that it is entitled to an ordinary loss on the disposition of NBC shares acquired in the years 1973 through 1976.

84 T.C. at 656-657; Pet. App. at B-20-21.

III. THE EIGHTH CIRCUIT'S REPUDIATION OF THE APPLICATION OF THE *CORN PRODUCTS* DOCTRINE TO CORPORATE STOCK RESTS ON ERRONEOUS REASONING

The Eighth Circuit's decision in this case rests upon two faulty legal arguments: (1) the result reached by the Tax Court required an unacceptable departure from the literal language of Section 1221, and constituted unwarranted judicial legislation; and (2) affirmance of the Tax Court's decision would foster uncertainty surrounding the characterization of stock as a capital or ordinary asset. These two lines of reasoning upon which the decision of the Eighth Circuit must stand (or fall) are hardly new. In *Corn Products*, the taxpayer raised virtually the identical arguments, only to have them rejected by this Court.

A. The Eighth Circuit's Failure to Follow this Court's Approach to Interpreting Section 1221 Distorts Congressional Intent

The decision of the Eighth Circuit below was, first and foremost, the result of a conclusion that corporate stock did not fall within the literal language of any exclusion to Section 1221's definition of capital asset.[15] Coupled with its belief that

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[15] The inability of the Eighth Circuit Court of Appeals to accept the fact that this Court in *Corn Products* deliberately refused to adopt a literal reading of the predecessor to Section 1221 in order to carry out the intended purpose of that section is linked to its misreading of this Court's decision in *United States v. Mississippi Chemical Corporation*, 405 U.S. 298 (1972). The only issue before this Court in *Mississippi Chemical* was whether or not the cost of the stock was currently deductible. This Court gave no consideration to the issue of whether the stock constituted a "capital asset" within the meaning of Section 1221. That issue was not addressed

"the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make," 800 F.2d at 221; Pet. App. at A-10, this conclusion ended the inquiry for the court of appeals. If no specific exclusion applied, the only result could be capital gain or loss treatment. The taxpayer in *Corn Products* similarly, but unsuccessfully, argued to this Court that corn futures contracts were to be treated as capital assets simply because they did not fall within any of the exclusions from the statutory definition of "capital asset." *See* Brief for Corn Products at 11.

The wooden application of the statutory language advocated by the Eighth Circuit could not possibly effectuate the intent of Congress in enacting Section 1221, but would open new vistas of tax avoidance by causing tax results to flow from the "inherent nature" of a type of asset, rather than from the purpose for which a particular taxpayer acquires and holds it. Clearly, "to permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities would seriously impair the effective administration of

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by either of the parties on brief, nor was it of any relevance to the Court's decision, since no disposition of that stock had occurred.

As the Government correctly stated in its brief:

> Respondents are not helped by cases purporting to apply the rationale of *Corn Products* . . . permitting ordinary loss treatment on the sale of corporate stock . . . . [T]he issue in these cases is whether or not the stock sold was a *capital* asset within the meaning of Section 1221. (It was assumed in each case that the stock was an asset.) Here, on the other hand, there has been no sale, and the issue is whether the stock purchased is an asset, not whether it is a capital asset.

Brief for United States at 37, fn. 33, *United States v. Mississippi Chemical Corporation*, 405 U.S. 298 (1972) (No. 71-52). Nonetheless, the Eighth Circuit cited *Mississippi Chemical* as supporting its literal interpretation of Section 1221.

the tax policies of Congress." *Commissioner v. Court Holding Co.*, 324 U.S. 331, 334 (1945) (sale of a building was in substance made by corporation; shareholder was mere conduit).

The position of the Government in *Corn Products* was, of course, adopted by this Court. More importantly, it was the *right* position from the multiple standpoints of proper statutory interpretation, true Congressional purpose, and tax equity. Even though the result in this individual case will be the imposition of less tax instead of more, it is to be hoped that the Government will again take the principled position here, rather than one oriented to the effect on the revenues of the Treasury.

This Court properly recognized in *Corn Products* that the ultimate goal of statutory interpretation is to effectuate the intent of the legislature, and not just to apply the words of the legislation.[16] Although the language of the statute is the starting point for ascertaining the intent of Congress, it is neither exclusive nor necessarily complete. Where the statutory language, if literally applied, would yield unreasonable results or apparently frustrate the purpose of Congress, neither this Court nor other great jurists have hesitated to interpret statutes in a nonliteral manner.[17]

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[16] *Church of The Holy Trinity v. United States*, 143 U.S. 457, 472 (1892) ("[W]e cannot think Congress intended to denounce with penalties a transaction like that in the present case. It is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers."); *United States v. American Trucking Association*, 310 U.S. 534, 542 (1940) ("In the interpretation of statutes, the function of the courts is easily stated. It is to construe the language so as to give effect to the intent of Congress.").

[17] *See United States v. American Trucking Association, supra* fn. 17, at 543 ("Frequently, however, even when the plain meaning did not

The special characteristics of tax legislation make this principle of statutory interpretation particularly appropriate. The general terms used in tax statutes must be applied to the vast array of human economic activity, and therefore must be applied in specific circumstances that Congress could not reasonably have contemplated. Moreover, the inherent complexity of the concepts involved in our tax system and imperfections in the process of drafting tax legislation counsel against any assumption that tax statutes mean precisely what they say, and nothing more. For these reasons, tax statutes often have been interpreted by this Court and others in a nonliteral manner.[18]

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produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole,' *Ozawa v. United States*, 260 U.S. 178, 194 (1922), this Court has followed that purpose, rather than the literal words.") *See also Commissioner v. Tufts*, 461 U.S. 300 (1983) (the requirement that the amount realized upon disposition of property equal the full amount of a nonrecourse mortgage even though in excess of the property's fair market value created a logical result, although not within the meaning of "amount realized" under Section 1001(b)). As Judge Learned Hand so candidly stated:

> Flinch as we may, what we do, and must do, is to project ourselves, as best we can, into the position of those who uttered the words and to impute to them how they would have dealt with the concrete occasion.

United States v. Klinger, 199 F.2d 645, 648 (2nd Cir. 1952), *aff'd per curiam*, 345 U.S. 979 (1953).

[18] *See Hillsboro National Bank v. Commissioner*, 460 U.S. 370 (1983) (corporation must recognize income under tax benefit rule despite express non-recognition treatment provided by Section 336(a)); *Commissioner v. Tufts*, 461 U.S. 300 (1983) (amount realized upon disposition equals the full amount of a nonrecourse mortgage in excess of the property's fair market value even though not within the meaning of "amount realized" as defined in Section 1001(b)); *Bob Jones University v. United States*, 461 U.S. 574 (1983) (a

Section 1221 provides an excellent example of the reasons why a statute should not be interpreted literally in all cases. The approach used by Congress was to include all "property" as a "capital asset" other than certain excluded property. Unfortunately, this highly inclusive definition would, if taken literally, lead to absurd results. For example, contract rights to various kinds of "ordinary" income would seem clearly to be "capital assets" under this provision.

> [T]he right to a salary earned, or to interest accrued, or a dividend due, is "property" in the legal sense. Does such a right when sold therefore transport the salary, interest, or dividend out of the ordinary income area and into the capital gain category via the term "property" in the definition of capital asset?

Surrey at 1004. None of the exclusions in Section 1221 is literally applicable to a sale of such rights. Nevertheless, it is obvious that a sale of such rights was not intended by Congress to, and should not, result in capital gains to the seller. The recognized exclusion of such items as rights to salaries and dividends from classification as "capital assets" is

> the result of a gentlemen's agreement by the courts that they will not in this area take literally the use of the term 'property' in the definition of capital assets . . . . Otherwise, these claims when sold would produce capital gains and thereby would permit all earnings to escape ordinary income taxation. *Id.* at 1004-05 fn. 52.

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qualifying "educational" organization under Section 501(c)(3) must additionally be charitable in the common law sense in order to qualify for tax exempt status); *Paulsen v. Commissioner*, 469 U.S. 131 (1985) (merger of state and chartered stock savings and loan with federally chartered mutual savings and loan did not qualify as tax-free reorganization since continuity of interest test not met even though transaction satisfied literal requirements of reorganization provisions).

Just as the courts refuse to be bound by the literal language of Section 1221 where necessary to avoid absurd and unintended results, they also are willing to go beyond its specific terms where necessary to carry out the obvious purpose of the statute. In this case, that purpose is to limit capital gains treatment to transactions not closely connected with the taxpayer's ordinary business. Such judicial interpretation is necessary precisely because the task of devising statutory language to fulfill this purpose is so inherently complex, especially where it is apparent that Congress has not attempted to do so in a comprehensive way.

In light of this Court's identification of the fundamental principles of Section 1221, it is clear that the Eighth Circuit's mechanical approach to interpreting that section in this case is inadequate. Instead of suggesting that this Court's decision in *Corn Products* was limited to its facts, 800 F.2d at 219; Pet. App. at A-7, it was the task of the court of appeals to acknowledge, as did Judge Hanson in dissent, that "*Corn Products* was merely an attempt to divine congressional intent." 800 F.2d at 221; Pet. App. at A-11. Unless there was some convincing indication that this Court incorrectly assessed that intent — and the Eighth Circuit certainly offered none — the rationale in *Corn Products* should have been applied in the court of appeals below.

This Court was presented in *Corn Products* with a rough Congressional tool whose imperfections were obvious. The Court stated clearly in *Corn Products* the way in which that tool was intended by its makers to be used, and left to later judicial craftsmen the task of refining and perfecting the tool to better serve the original purpose of its legislative makers. Over the last three decades, those craftsmen have done their job well, improving not only the utility and precision of the tool, but their own skills in wielding it, and the results evi-

dently have been acceptable to the Congress. The decision of the court of appeals below would mandate, in the name of Congressional intent, that the courts scrap all improvements and henceforth use only the original blunt instrument.

B. Congress has Recognized and Approved the Operation of the *Corn Products* Doctrine

In fact, the court of appeals below had ample additional evidence that *Corn Products* was rightly decided. As that case itself held, it is an established principle that Congress implicitly validates longstanding judicial interpretations of tax legislation when it reenacts that legislation without substantial change. *See, e.g., Corn Products*, 350 U.S. at 53; *Helvering v. Winmill*, 305 U.S. 79 (1938). "Congress is presumed to be aware of settled judicial construction and thus adopts that construction unless it affirmatively acts to change it." *Fink v. Commissioner*, 789 F.2d 427, 433 (6th Cir.), *cert. granted*, 107 S.Ct. 454 (1986). When this Court renders a decision in the tax arena with which Congress disagrees, especially one with the enormous practical significance of *Corn Products*, Congress has been quick to act so as to make clear its intentions.[19]

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[19] *See United States v. Hendler*, 303 U.S. 564 (1938), where the Government successfully argued that in an otherwise tax-free corporate reorganization, the acquiring corporation's assumption of liabilities of the target ought to trigger gain to the target. As a result of this decision, innumerable tax-free reorganizations were rendered invalid, imposing an enormous tax burden on target companies if the statute of limitations had not run. To correct this problem, Congress amended Section 112(b)(5) of the Revenue Act of 1928, Pub. L. No. 70-562, 45 Stat. 791 (1928), overturning the *Hendler* decision retroactive to 1924. *See* Revenue Act of 1939, Pub. L. No. 76-155, §213(c), 53 Stat. 862 (1939); *See also* Ginsburg, "Making Tax Law Through the Judicial Process," 70 *American Bar Association Journal* 74, 76 (1984).

In this instance, the doctrine of *Corn Products* has been the subject of extensive commentary and judicial exegesis for decades.[20] Literally dozens of cases during the last thirty years uniformly have held that the categorization of gain or loss resulting from the sale of an asset as ordinary or capital depends upon the taxpayer's purposes and other factual circumstances.[21] During that period, Congress has amended Section 1221 three times without ever suggesting that all of those consistent judicial interpretations were "misbegotten" or contrary to the intent of Congress.[22] It was the court of appeals in

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[20] *See* cases cited in fn. 7, *supra* at p. 10; *see also*, Surrey, "Definitional Problems in Capital Gains Taxation," 69 *Harv. L. Rev.* 985 (1956); Miller, "The Unpleasant Taste of *Corn Products*," 53 *S. Cal. L. Rev.* 311 (1979); Troxell & Noall, "Judicial Erosion of the Concept of Securities as Capital Assets," 19 *Tax L. Rev.* 185 (1964); and Javaras, "Corporate Gains and Losses — The *Corn Products* Doctrine," 52 *Taxes* 770 (1974).

[21] *See, e.g., Campbell Taggart, Inc.*, 744 F.2d at 457 ("The cases indicate that the test of *Corn Products* is whether the asset was acquired with a business purpose or an investment purpose."); *F.S. Services, Inc. v. United States*, 413 F.2d 548, 554 (Ct. Cl. 1969) ("proper and valid business considerations rather than intent to make a capital investment"); *Mansfield Journal Company v. Commissioner*, 274 F.2d 284, 286 (6th Cir. 1960) ("motive . . . of a capital investor . . . [or] of a far-sighted manufacturer").

[22] Section 1221 has been amended three times since this Court's decision in *Corn Products*. The Tax Reform Act, Pub. L. No. 91-172, § 514(a), 83 Stat. 487, 643 (1969), amended Section 1221(3) to read as above at pages 2-3. The amendment was applicable to sales and other dispositions occurring after July 25, 1969. Prior to amendment, Section 1221(3) read as follows:

> (3) a copyright, a literary, musical, or artistic composition, or similar property, held by —
>
> (A) a taxpayer whose personal efforts created such property, or

this case which first "discovered" such alleged defects in these decisions — defects to which Congress itself has not objected.

Of even greater significance than the reenactment of Section 1221 without change is the fact that in 1976 a bill[23] was reported out of the House Ways and Means Committee which specifically addressed the issue of "Tax Treatment of Securities Acquired for Business Reasons and not as an Investment."[24] The proposed bill would have added a new provision to

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> (B) a taxpayer in whose hands the basis of such property is determined, for the purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property.

The Tax Reform Act of 1976, Pub. L. No. 94-455, §2132(a), 90 Stat. 1520, 1925 (1976), amended Section 1221 by adding paragraph (6) (what is now paragraph (5)), applicable to sales, exchanges, and contributions made after October 4, 1976. The same Act, at §1901(c)(9), amended Section 1221(5) by striking out "or Territory," following the word "State," with respect to taxable years beginning after December 31, 1976.

The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, §505(a), 95 Stat. 172, 331 (1981), repealed former Section 1221(5) and redesignated Section 1221(6) as Section 1221(5), applicable to property acquired or positions established after June 23, 1981, in the years ending after that date. Prior to amendment, former Section 1221(5) read as follows:

> (5) an obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue; or

[23] H. R. 10902, 94th Cong., 2d Sess. (1976).

[24] H. R. Rep. No. 1360, 94th Cong., 2d Sess. 1976) [hereinafter cited as "H. R. Rep. No. 1360"].

the Internal Revenue Code which required a taxpayer to notify the Secretary within thirty days after initially acquiring a security if the acquisition was not made as an investment. Only by filing the notice could a taxpayer preserve the right to seek ordinary loss treatment on a subsequent sale or exchange of that security. In a discussion of the law in existence at that time, the Committee Report stated:

> Under present law, the treatment of gain or loss on the sale or exchange of a stock or other security depends on whether the security is a capital asset in the hands of the taxpayer.... If a stock or other security is held for business purposes, it generally is not treated as a capital asset....

H.R. Report No. 1360 at 2.

Thus, the Committee clearly demonstrated its understanding of the applicable law — an understanding which is irreconcilable with the holding of the Eighth Circuit in this case. In further discussing the reasons for the bill, the Committee Report stated:

> The question of whether a security (or any asset) is a capital asset is factual and depends on the facts and circumstances of the particular case, i.e., whether the taxpayer acquired and held the security as an investment or whether he acquired and held it for sale to customers in the ordinary course of business or held the stock for use in his business.

Id. at 3. The bill was passed by the House of Representatives, but was never approved by the Senate.

This Court has viewed as very significant the fact that Congress, as it did here, had previously considered, but eventually rejected, a legislative response to an issue perceived by the Treasury Department to be a problem. In *Commissioner v.*

Brown, 380 U.S. 563 (1965), this Court considered the question of whether the sale of all of the assets of a taxpayer to a tax-exempt entity for a price which was payable only from the income produced by the assets sold qualified as a "sale" for purposes of the capital gains provisions. In deciding that case, this Court noted that the Treasury Department had in 1963 proposed a change in the law which would have taxed as ordinary income payments on the sale of a capital asset which were deferred over more than five years and were contingent on future income. *Brown*, 380 U.S. at 578. This Court noted that while Congress did not adopt the suggested change, "it is significant for our purposes that the proposed amendment did not deny the fact or occurrence of a sale but would have taxed as ordinary income those income-contingent payments deferred for more than five years." *Id.* This Court concluded that, in such cases, it was wise to "leave to the Congress the fashioning of a rule which, in any event, must have wide ramifications." 380 U.S. at 579, *citing American Automobile Association v. United States*, 367 U.S. 687, 697 (1961).

The situation with respect to H.R. 10902 is identical. Nowhere in the legislative history of that proposed bill did Congress indicate that it disagreed with the extensive judicial authority which held that whether an asset is a capital asset depends on a factual determination of whether it was held for a business purpose. Instead, the existence of that rule was expressly acknowledged.

In fact, the Treasury Department had expressly requested that the Committee consider whether Section 1221 should be amended to provide that capital stock should *never* be accorded ordinary loss or gain treatment. Joint Committee on Internal Revenue Taxation, 94th Cong., 1st Sess., *Description of Technical and Minor Bills listed for a Hearing By the Committee on Ways and Means on December 10, 1975*, 56, 58 (December 9,

1975). Congress declined to do so, thereby confirming that this Court in *Corn Products* correctly identified the legislative intent underlying Section 1221. Indeed, the unavoidable conclusion is that Congress declined to adopt the very principle which the Eighth Circuit Court of Appeals has "enacted" in this case. It plainly is *that* ruling which represents true "judicial legislation."

C. Any Administrative Problems Envisioned by the Eighth Circuit Plainly have been Insufficient to Prompt Congress or the Internal Revenue Service to Adopt any Corrective Measures

The second rationale for the decision of the court of appeals below was its belief that the settled interpretation of Section 1221 evidenced by *Corn Products* and its progeny "foster[s] subjectivity and uncertainty" and leads to "increased recourse to the administrative and judicial processes." 800 F.2d at 221; Pet. App. at A-10. This, too, is not a new argument. The taxpayer in *Corn Products* contended strenuously that "great uncertainty in the administration and application of the capital limitations will follow" if the Government's position in that case was upheld. Reply Brief for Corn Products at 28. This Court was not moved by this alarum, and our system of tax administration seems to have survived.

In fact, concern that determinations regarding individual taxpayer motivation will cause excessive "recourse to the administrative and judicial processes" seems largely confined to the Eighth Circuit. The Tax Court and many other courts have applied the principles of *Corn Products* to a myriad of factual situations with no greater difficulty than is ordinarily encountered in the common judicial process of applying governing

legal principles in specific cases.[25] None seemed shaken by the prospect prior to the decision by the court of appeals below. Moreover, it is apparent from H.R. 10902 that Congress is capable of devising administrative solutions to deal with any such concerns, and that it does not yet view them as sufficiently significant to require any action.[26]

More fundamentally, such an argument ignores the fact that application of Section 1221 to specific situations inherently and unavoidably involves subjective determinations and other fac-

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[25] The fact that a tax concept requires an analysis of a taxpayer's motives, information which does not appear on a tax return, does not handicap the Internal Revenue Service's ability to maintain a position contrary to that of a taxpayer. If the sheer number of cases which have considered the real estate dealer versus investor issue under Section 1221(1) is any indication, the Commissioner has experienced no such difficulty. *See, e.g., McManus v. Commissioner*, 65 T.C. 197 (1975), *aff'd*, 583 F.2d 443 (9th Cir. 1978), *cert. denied*, 440 U.S. 959 (1979) (taxpayer found to be a dealer on twelve sales over seven-year period). *See also Byram v. United States*, 707 F.2d 1418 (5th Cir. 1983).

[26] Sometimes, however, administrative problems do rise to a level which requires Congressional action. For example, consider the impetus for construction of objective hobby loss rules, currently contained in Section 183. Congress evidently was moved by the apparent fact that judicial attempts to divine taxpayers' motive in pursuing a so-called hobby activity did not yield a single victory for the Government. 88 Cong. Rec. S 8034-35 (1943) (statement of Sen. Danaher). Congress' response was to formulate an objective test for distinguishing between hobby losses and ordinary business losses by establishing a rebuttable "for profit" presumption if the activity generates a profit three or more years out of five consecutive years. If Congress ever concludes that the issue presented by this case requires analagous action, it no doubt will act. It is not the proper function of the Eighth Circuit to come to such a conclusion itself, and then unilaterally to alter the interpretation of Section 1221 which Congress understands and accepts.

tual issues. For example, Section 1221 states that a sale of property will result in ordinary income or loss if it is "inventory." It is impossible, however, to ascertain whether an item is "inventory" without knowing the facts regarding the taxpayer's business and his purposes in acquiring and holding the item. For example, if a taxpayer were to announce that he owned a bar of gold, it would not be possible to determine whether that bar of gold was held by the taxpayer as inventory or as an investment qualifying as a capital asset without first obtaining additional information as to the purpose or use to which the taxpayer intended to put the asset. If the taxpayer was engaged in the business of selling precious metals, the gold bar might constitute inventory in his hands. On the other hand, a taxpayer might intend to hold the gold bar to finance his retirement through its future potential appreciation in value, and it then would qualify as a capital asset. In either case, it is impossible to determine whether the asset qualifies as a capital asset without knowing the taxpayer's motives for the purchase. It is equally impossible to determine whether corporate stock is or is not a capital asset without making a determination as to the use to which that asset is, or will be, put.

IV. THE PROPER TEST UNDER *CORN PRODUCTS* IS THE DOMINANT MOTIVE TEST

If this Court correctly upholds Arkansas Best's reliance on this Court's decision in *Corn Products*, and over thirty years of consistent case law, the decision of the court of appeals must be reversed. Based on the unchallenged factual findings of the Tax Court as to the purpose for Arkansas Best's post-1972 acquisitions of Bank stock, the Tax Court's holding that the losses resulting from the sales of that stock were ordinary losses should be affirmed on remand. As to the 1972 stock acquisition, the Eighth Circuit should review the Tax Court's

findings under the appropriate legal standard. Accordingly, this Court should determine as part of its decision in this case the proper test for differentiating between capital and ordinary assets under the *Corn Products* doctrine.

Two principal tests for determining whether an asset should be characterized as an ordinary asset have emerged from the many cases interpreting *Corn Products*. These two tests are the "dominant business motive" test and the "substantial investment motive" test. Under the first test, an asset is characterized as an ordinary, non-capital asset if the dominant or primary motive for its acquisition was business-related. The second test also require the presence of a dominant business motive, but in addition requires the absence of any substantial investment motive. Thus, in a "mixed motivation" case — one in which the taxpayer's primary motive is business-related, but a substantial investment motive also exists — the second test would cause a different result than the dominant motive test. Based upon this Court's adoption of the dominant motive test for resolution of the "business versus investment" issue in analogous areas of tax law, and the fundamental flaws of the substantial investment motive test, this Court should hold that the dominant motive test is the correct one under the *Corn Products* doctrine.

In *Corn Products*, this Court established that an asset must be "integral" to, or arise from the everyday operation of, the taxpayer's business in order to be property for which Congress intended ordinary or non-capital treatment. 350 U.S. at 50, 52. Subsequent to *Corn Products* and prior to the Tax Court's decision in *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S. 966 (1977), courts both expressly and implicitly employed a primary or dominant motive analysis as the operative demarcation between capital

and ordinary assets. *See Booth Newspapers*, 303 F.2d at 921; *Steadman*, 424 F.2d at 5. Although a number of the factual situations considered by these courts had contained evidence of both business and investment motivations,[26] no court had felt compelled to address the issue of mixed motivations. Even the Internal Revenue Service initially agreed with these courts' approach and adopted the primary motive test in Revenue Ruling 75-13, 1975-1 C.B. 7 (predominant motive test applied to characterize the worthlessness of stock held by an employee in his employer corporation).[27]

In *W. W. Windle Co.*, the Tax Court faced this issue of mixed motivations head on. The court found that although the taxpayer, a wool processor, had acquired the stock of a wool mill primarily to secure a captive customer, a recognized business purpose, the taxpayer held a secondary and substantial motive to acquire the stock as an investment. 65 T.C. at 703. Treating the mixed motive issue as one of first impression, the court acknowledged that adoption of a dominant motive test would

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[26] *See* Natbony, "Whither *Windle*?", 24 *St. Louis U. L. Rev.* 67, 72-73 (1979).

[27] Consistent with its current position and the apparently favorable holding in *W. W. Windle Co., supra*, the Internal Revenue Service subsequently revoked Revenue Ruling 75-13 in 1978. *See* Revenue Ruling 78-94, 1978-1 C.B. 58. However, in revoking Revenue Ruling 75-13, Revenue Ruling 78-94 announced that this change in position would not be applied adversely to taxpayers who acquired stock before March 13, 1978, if such stock was disposed of before September 13, 1978. In this case, all of the Bank stock acquired by Arkansas Best was sold prior to this latter date. Although the Commissioner clearly has the authority under Section 7805(b) to change his position retroactively, where he expressly chooses not to do so, that publicly-announced decision should be binding. Accordingly, the Commissioner should be estopped from applying the post-*Windle* standard announced in Revenue Ruling 78-94 to Arkansas Best's acquisition and sale of Bank stock in this case.

both give "effect to the Supreme Court's admonition" that the capital asset exclusions be broadly construed and maintain a uniform standard in the courts. 65 T.C. at 712. Yet, without citing a single legal authority to refute these "persuasive arguments," *id.*, the Tax Court rejected the dominant motive test and held that where a substantial, albeit secondary, investment motive exists, corporate stock will be deemed to be a capital asset.

This Court has twice held that the proper standard for differentiating between business and investment purposes in situations of dual taxpayer motivations is the dominant business motive test. In *Malat v. Riddell*, 383 U.S. 569 (1966), the taxpayer entered a joint venture for the principal purpose of development of rental property. Since the property had been purchased at a good price, the venturers had a secondary motive to sell the property in the event the development venture fell through. 383 U.S. at 570. When financing was not obtained and some venturers grew disgruntled, the venture sold the property at a gain.

The Government contended that the taxpayer's share of such gain was ordinary because the venturers' secondary, but nevertheless "substantial," intent to sell the property placed the property within the first exclusion to the capital asset definition for property held "primarily for sale to customers in the ordinary course of [taxpayer's] trade or business." The sole issue before this Court was whether a "controlling" or "substantial" business motive is needed to satisfy "primarily" as used in Section 1221(1). The Government urged a broad reading of "primarily," in line with this Court's admonition to broadly construe the exclusions to the definition of capital asset. Brief for Riddell at 16-17, *Malat v. Riddell*, 383 U.S. 569 (1966) (No. 487). A unanimous Court rejected the Government's interpretation, preferring to define "primarily" in com-

monsense fashion to mean "of first importance" or "principally" for purposes of Section 1221(1). 383 U.S. at 572. The Court reiterated the basic and pervading distinction between capital and ordinary treatment:

> The purpose of [Section 1221] is to differentiate between the "profits and losses arising from the everyday operation of a business" on the one hand (*Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 52) and "the realization of appreciation in value accrued over a substantial period of time" on the other. (*Commissioner v. Gillette Motor Transport, Inc.*, 364 U.S. 130, 134)

383 U.S. at 572.

In effecting this purpose, both the statutory and judicial exclusions, the substance of which the capital asset definition is made, must each be interpreted consistently with one another. "Primarily," which defines the relationship between the taxpayer's property and business under the Section 1221(1) exclusion, is effectively equated with "integral," which defines the necessary relationship under the judicially devised exclusion in *Corn Products*. Therefore, a business motive that is "primary" or "of first importance" in the purchase and holding of property should constitute the necessary integration of the property and taxpayer's trade or business so as to be excluded from characterization as a capital asset under the *Corn Products* doctrine, regardless of the existence of a substantial, but secondary, investment motive.

In *United States v. Generes*, 405 U.S. 93 (1972), this Court expressly advocated use of the dominant motive test in distinguishing between the business and investment characterization of loans by an employee-shareholder to its employer. The taxpayer, a major stockholder and president of a construction company, loaned over $150,000 to his company for the primary

purpose of protecting his stock investment. The trial court additionally found a secondary and significant taxpayer motive of preserving his employment position. When the debt became worthless, the taxpayer claimed a business bad debt loss under Section 166(a), which could then be used to offset ordinary income. The Government contended that the obligation was a non-business debt that must be treated as a short-term capital loss under Section 166(d). The issue before this Court, therefore, was whether the "proximate" relation between the debt and the taxpayer's business that was required for business characterization was satisfied either by a "dominant" business motivation or a "significant" business motivation.

The Court first emphasized that the Internal Revenue Code carefully distinguishes between business and non-business debts for the purposes of Sections 162, 165, and 166. The Court found that since any taxpayer who holds a status as both an employee and shareholder almost assuredly will have a significant interest in preserving his employment, a "significant motivation" test would effectively obliterate the domain of the non-business debt in this context. In addition, the Court found that the "dominant motivation" standard best preserved the meaningful distinction between business and non-business activities. This Court summarized this standard as having

> the attribute of workability. It provides a guideline of certainty for the trier of fact. The trier then may compare the risk against the potential reward and give proper emphasis to the objective rather than to the subjective. . . . By making the dominant motivation the measure, the logical tax consequence ensues and prevents the mere presence of a business motive, however small and however insignificant, from controlling the tax result at the taxpayer's convenience.

405 U.S. at 104. Such language represents nothing short of a ringing endorsement of the dominant motive test.

In applying the dominant business motive test in this case, the Tax Court's factual findings must be accepted since there is no claim that those factual findings were clearly erroneous. Fed. R. Civ. Proc. 52(a); *Commissioner v. Duberstein*, 363 U.S. 278, 291 (1960). Therefore, assuming that this Court concludes that the proper interpretation of Section 1221 involves determining the motives of a taxpayer for acquiring an asset, the factual conclusions reached by the Tax Court below with respect to the Bank stock acquired after 1972 are determinative of the issues before this Court. As this court noted in *Corn Products:*

> For tax purposes petitioner's purchases have been found to "constitute an integral part of its manufacturing business" by both the Tax Court and the Court of Appeals, and on essentially factual questions the findings of two courts should not ordinarily be disturbed.

350 U.S. at 51. With respect to the stock acquired in 1972, this case should be remanded to the Court of Appeals so that the rules of law announced by this Court can be applied properly.

CONCLUSION

In light of the Tax Court's conclusion that Bank stock acquired after 1972 was acquired solely for business purposes, the decision of the Eighth Circuit Court of Appeals with respect to Bank stock acquired after 1972 should be reversed, and the losses incurred on the subsequent sales of that stock should be accorded ordinary loss treatment. With respect to Bank stock acquired in 1972, and the Bank stock acquired from Universal, the decision of the Eighth Circuit Court of Appeals should be reversed and remanded, with directions that the

Corn Products doctrine be applied utilizing a dominant motive test. With respect to the acquisitions of Bank stock made by Arkansas Best in 1972, Arkansas Best believes that it can show on remand that those acquisitions, while perhaps not solely business motivated as were the post-1972 acquisitions, nonetheless were predominantly business motivated given the fact that Arkansas Best had filed a notice in 1971 wherein it irrevocably committed itself to divesting its interest in the Bank stock.

Respectfully submitted,

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